PART I

Items 1 and 2. *Business And Properties*

General

We are a publicly traded Delaware limited partnership (the "Partnership") engaged in interstate and intrastate marketing, transportation and terminalling of crude oil and marketing of liquefied petroleum gas ("LPG"). We were formed in September 1998 to acquire and operate the midstream crude oil business and assets of Plains Resources Inc. and its wholly-owned subsidiaries ("Plains Resources") as a separate, publicly traded master limited partnership. We completed our initial public offering in November 1998. Immediately after our initial public offering, Plains Resources owned 100% of our general partner interest and an overall effective ownership in the Partnership of 57% (including the 2% general partner interest and common and subordinated units owned by it). As discussed below, Plains Resources' effective ownership interest in the Partnership has been reduced substantially.

In May 2001, senior management and a group of financial investors entered into a transaction with Plains Resources to acquire majority control of our general partner and a majority of the outstanding subordinated units. The transaction closed in June 2001 and, for purposes of this report, is referred to as the "General Partner Transition." As a result of this transaction and subsequent equity offerings, Plains Resources' overall effective ownership in us was reduced to approximately 25%. See Item 12. "Security Ownership of Certain Beneficial Owners and Management." In addition, certain senior officers of the general partner that previously were also officers of Plains Resources, terminated their affiliation with Plains Resources and now devote 100% of their efforts to the management of the Partnership.

The general partner interest is now held by Plains AAP, L.P., a Delaware limited partnership. Plains All American GP LLC, a Delaware limited liability company, is Plains AAP, L.P.'s general partner. Plains All American GP LLC manages our operations and activities and employs our officers and personnel. Unless the context otherwise requires, we use the term "general partner" to refer to both Plains AAP, L.P. and Plains All American GP LLC. We use the phrase "former general partner" to refer to the subsidiary of Plains Resources that formerly held the general partner interest.

Our operations are concentrated in Texas, Oklahoma, California and Louisiana and in the Canadian provinces of Alberta and Saskatchewan, and can be categorized into two primary business activities:

- *Crude Oil Pipeline Transportation Operations*. We own and operate over 5,600 miles of gathering and mainline crude oil pipelines located throughout the United States and Canada. Our activities from pipeline operations generally consist of transporting crude oil for a fee, third party leases of pipeline capacity, barrel exchanges and buy/sell arrangements.

- *Gathering, Marketing, Terminalling and Storage Operations*. We own and operate approximately 22.7 million barrels of above-ground crude oil terminalling and storage facilities, including tankage associated with our pipeline systems. These facilities include a crude oil terminalling and storage facility at Cushing, Oklahoma. Cushing, which we refer to in this report as the Cushing Interchange, is one of the largest crude oil market hubs in the United States and the designated delivery point for NYMEX crude oil futures contracts. Our terminalling and storage operations generate revenue through a combination of storage and throughput charges to third parties. We also utilize our storage tanks to counter-cyclically balance our gathering and marketing operations and to execute different hedging strategies to stabilize profits and reduce the negative impact of crude oil market volatility. See "—Crude Oil Volatility; Counter-Cyclical Balance; Risk Management." Our gathering and marketing operations include:

- the purchase of crude oil at the wellhead and the bulk purchase of crude oil at pipeline and terminal facilities;
- the transportation of crude oil on trucks, barges and pipelines;
- the subsequent resale or exchange of crude oil at various points along the crude oil distribution chain; and
- the purchase of LPG from producers, refiners and other marketers, and the sale of LPG to wholesalers, retailers and industrial end users.

Business Strategy

Our business strategy is to capitalize on the regional crude oil and LPG supply and demand imbalances that exist in the United States and Canada by combining the strategic location and unique capabilities of our transportation and terminalling assets with our extensive marketing and distribution expertise to generate sustainable earnings and cash flow.

We intend to execute our business strategy by:

- increasing and optimizing throughput on our existing pipeline and gathering assets and realizing cost efficiencies through operational improvements;

- utilizing and expanding our Cushing Terminal and our other assets to service the needs of refiners and to profit from merchant activities that take advantage of crude oil pricing and quality differentials;

- selectively pursuing strategic and accretive acquisitions of crude oil and LPG transportation assets, including pipelines, gathering systems, terminalling and storage facilities and other assets that complement our existing asset base and distribution capabilities; and

- optimizing and expanding our Canadian operations to take advantage of anticipated increases in the volume and qualities of crude oil produced in Canada and exported to U.S. markets.

Financial Strategy

We believe that a major factor in our continued success will be our ability to maintain a low cost of capital and access to the capital markets. Since our initial public offering in 1998, we have consistently communicated to the financial community our intention to maintain a strong credit profile that we believe is consistent with our goal of achieving and maintaining an investment grade credit rating. We have targeted a general credit profile with the following attributes:

- an average long-term debt-to-total capitalization ratio of approximately 60% or less;

- an average long-term debt-to-EBITDA ratio of approximately 3.5x or less; and

- an average EBITDA-to-interest coverage ratio of approximately 3.3x or better.

As of December 31, 2002, we were within our targeted credit profile. In order for us to maintain our targeted credit profile and achieve growth through acquisitions, we intend to fund acquisitions using approximately equal proportions of equity and debt. Because it is likely that acquisitions will initially be financed using debt and it is difficult to predict the actual timing of accessing the market to raise equity, from time to time we may be temporarily outside the parameters of our targeted credit profile.

In February 2003, Standard & Poor's upgraded our corporate credit rating to investment grade, assigning us a rating of BBB-, stable outlook. In September 2002, Moody's Investor Services upgraded our senior implied credit rating to Ba1, stable outlook. You should note that a credit rating is not a recommendation to buy, sell or hold securities, and may be subject to revision or withdrawal at any time.

Competitive Strengths

We believe that the following competitive strengths position us to successfully execute our business strategy:

- ***Our pipeline assets are strategically located and have additional capacity***. Our primary crude oil pipeline transportation and gathering assets are located in prolific oil producing regions and are connected, directly or indirectly, with our terminalling and storage assets that service major North American refinery and distribution markets, where we have strong business relationships. These assets are strategically positioned to maximize the value of our crude oil by transporting it to major trading locations and premium markets. Our pipeline networks currently possess additional capacity that can accommodate increased demand.

- ***Our Cushing Terminal is strategically located, operationally flexible and readily expandable***. Our Cushing Terminal interconnects with the Cushing Interchange's major inbound and outbound pipelines, providing access to both foreign and domestic crude oil. Our Cushing Terminal is the most modern large-scale terminalling and storage facility at the Cushing Interchange, incorporating (1) operational enhancements designed to safely and efficiently terminal, store, blend and segregate large volumes and multiple varieties of crude oil and (2) extensive environmental safeguards. Collectively, our Phase II expansion project, which became operational in July 2002, and our Phase III expansion project, which became operational in January 2003, increased the total capacity of our Cushing Terminal by approximately 70% to approximately 5.3 million barrels. We believe that the facility can be further expanded to meet additional demand should market conditions warrant. In addition, we own approximately 17.4 million barrels of above-ground crude oil terminalling and storage assets elsewhere in the United States and Canada that complement our Cushing Terminal and enable us to serve the needs of our customers.

- ***We possess specialized crude oil market knowledge***. We believe our business relationships with participants in all phases of the crude oil distribution chain, from crude oil producers to refiners, as well as our own industry expertise, provide us with an extensive understanding of the North American physical crude oil markets.

- ***Our business activities are counter-cyclically balanced***. We believe that our terminalling and storage activities and our gathering and marketing activities are counter-cyclical. We believe that this balance of activities, combined with pipeline transportation operations, has a stabilizing effect on our cash flow from operations.

- ***We have the financial flexibility to continue to pursue expansion and acquisition opportunities*.** We believe we have significant resources to finance strategic expansion and acquisition opportunities, including our ability to issue additional partnership units, borrow under our credit facility and issue additional notes in the long-term debt capital markets. The amount of unused capacity available under our revolving credit facility at December 31, 2002, was approximately $436.9 million. Our usage is subject to covenant compliance. See Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Credit Facilities and Long-Term Debt."

- ***We have an experienced management team whose interests are aligned with those of all of our stakeholders*.** Our executive management team has an average of more than 20 years industry experience, with an average of over 15 years with us or our predecessors and affiliates. Members of our senior management team own a 4% interest in our general partner and, through restricted unit grants and options, own significant contingent equity incentives that vest only if we achieve specified performance objectives. In addition, our senior management team collectively owns approximately 300,000 common and subordinated units.

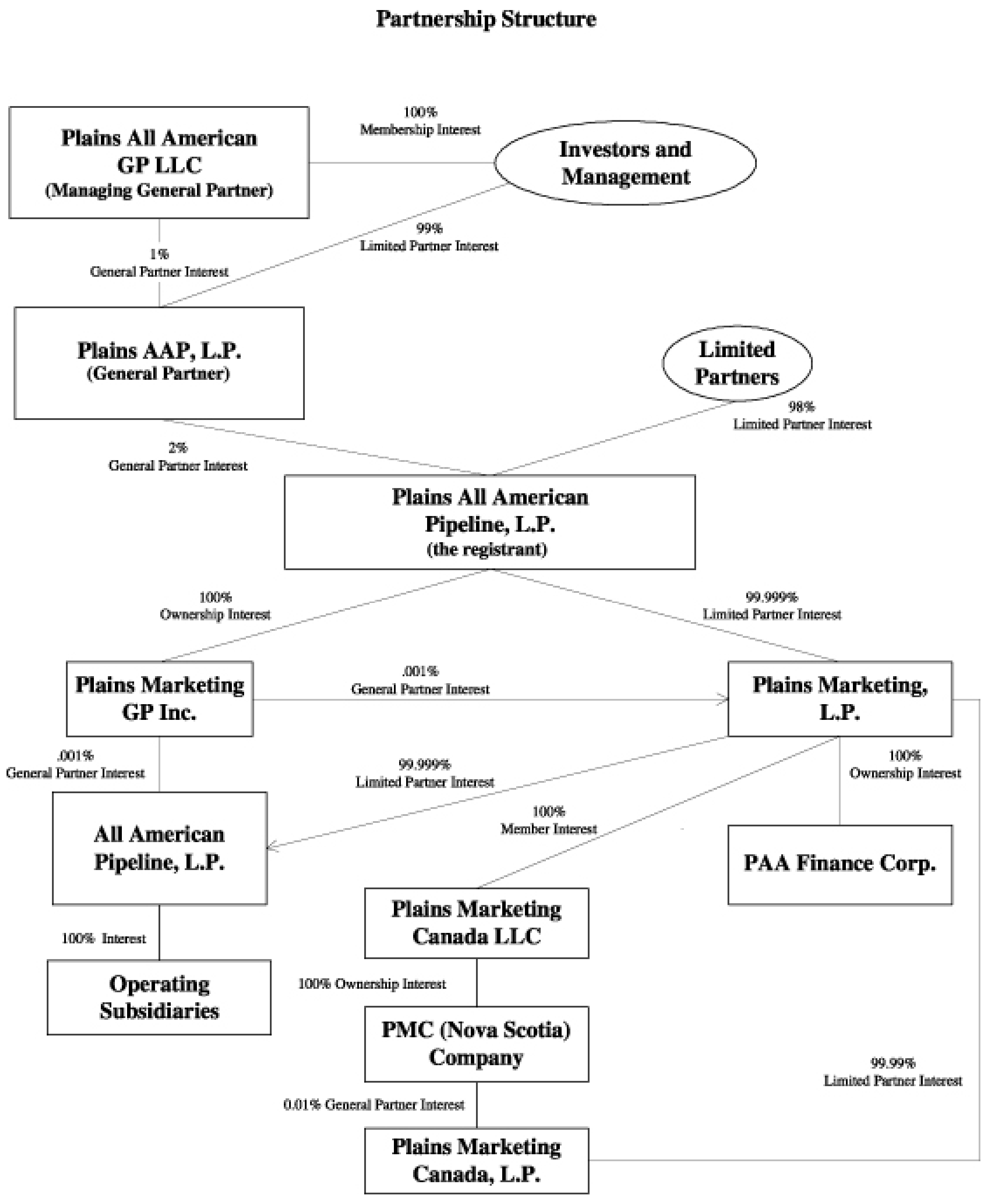
Partnership Structure and Management

Our operations are conducted through, and our operating assets are owned by, our subsidiaries. We own our interests in our subsidiaries through two operating partnerships, Plains Marketing, L.P. and All American Pipeline, L.P. Our Canadian operations are conducted through Plains Marketing Canada, L.P.

Our general partner, Plains AAP, L.P., is a limited partnership. Our general partner is managed by its general partner, Plains All American GP LLC, which has ultimate responsibility for conducting our business and managing our operations. Our general partner does not receive any management fee or other compensation in connection with its management of our business, but it is reimbursed for all direct and indirect expenses incurred on our behalf. Canadian personnel are employed by Plains Marketing Canada L.P.'s general partner, PMC (Nova Scotia) Company.

Our general partner has responsibility for conducting our business and managing our operations, and owns all of the incentive distribution rights. These rights provide that our general partner receives an increasing percentage of cash distributions (in addition to its 2% general partner interest) as distributions reach and exceed certain threshold levels. See Item 5. "Market for the Registrant's Common Units and Related Unitholder Matters—Cash Distribution Policy."

The chart below depicts the current organization and ownership of Plains All American Pipeline, the operating partnerships and the subsidiaries.



Major Acquisitions and Dispositions

An integral component of our business strategy and growth objective is to acquire assets and operations that are strategic and complementary to our existing operations. We have established a target to make $200 million to $300 million per year in acquisitions, subject to availability of attractive assets on acceptable terms. Since 1998, we have completed numerous acquisitions for an aggregate purchase price of approximately $1.1 billion. In addition, from time to time we have sold assets that are no longer considered essential to our operations. Following is a brief description of major acquisitions and dispositions that have occurred since our initial public offering in November 1998.

Shell West Texas Assets

On August 1, 2002, we acquired interests in approximately 2,000 miles of gathering and mainline crude oil pipelines and approximately 8.9 million barrels (net to our interest) of above-ground crude oil terminalling and storage assets in West Texas from Shell Pipeline Company LP and Equilon Enterprises LLC (the "Shell acquisition"). The primary assets included in the transaction are interests in the Basin Pipeline System ("Basin System"), the Permian Basin Gathering System ("Permian Basin System") and the Rancho Pipeline System ("Rancho System"). The total purchase price of $324.4 million consisted of (i) $304.0 million in cash, which was borrowed under our revolving credit facility, (ii) approximately $9.1 million related to the settlement of pre-existing accounts receivable and inventory balances and (iii) approximately $11.3 million of estimated transaction and closing costs.

The acquired assets are primarily fee-based mainline crude oil pipeline transportation assets that gather crude oil in the Permian Basin and transport that crude oil to major market locations in the Mid-Continent and Gulf Coast regions. The acquired assets complement our existing asset infrastructure in West Texas and represent a transportation link to Cushing, Oklahoma, where we provide storage and terminalling services. In addition, we believe that the Basin system is poised to benefit from potential shut-downs of refineries and other pipelines due to the shifting market dynamics in the West Texas area. As was contemplated at the time of the acquisition, the Rancho system will be taken out of service in March 2003, pursuant to the terms of its operating agreement. See "—Pipeline Operations—Pipeline Assets—Southwest U.S.—Rancho Pipeline System."

Canadian Expansion

In early 2000, we articulated to the financial community our intent to establish a strong Canadian operation that substantially mirrors our operations in the United States. After evaluating the marketplace and analyzing potential opportunities, we consummated the two transactions detailed below in 2001. The combination of these assets, an established fee-based pipeline transportation business and a rapidly-growing, entrepreneurial gathering and marketing business, allowed us to optimize both businesses and establish a solid foundation for future growth in Canada.

CANPET Energy Group, Inc.

In July 2001, we purchased substantially all of the assets of CANPET Energy Group Inc., a Calgary-based Canadian crude oil and LPG marketing company, for approximately $42.0 million plus $25.0 million for additional inventory owned by CANPET. Approximately $18.0 million of the purchase price, payable in common units, was deferred subject to various performance standards being met. See Note 8 "Partners' Capital and Distributions" in the "Notes to the Consolidated Financial Statements." The principal assets acquired include a crude oil handling facility, a 130,000-barrel tank facility, LPG facilities, existing business relationships and operating inventory.

Murphy Oil Company Ltd. Midstream Operations

In May 2001, we completed the acquisition of substantially all of the Canadian crude oil pipeline, gathering, storage and terminalling assets of Murphy Oil Company Ltd. for approximately $161.0 million in cash, including financing and transaction costs. The purchase price included $6.5 million for excess inventory in the systems. The principal assets acquired include approximately 560 miles of crude oil and condensate mainlines (including dual lines on which condensate is shipped for blending purposes and blended crude is shipped in the opposite direction) and associated gathering and lateral lines, approximately 1.1 million barrels of crude oil storage and terminalling capacity located primarily in Kerrobert, Saskatchewan, approximately 254,000 barrels of pipeline linefill and tank inventories, and 121 trailers used primarily for crude oil transportation.

West Texas Gathering System

In July 1999, we completed the acquisition of the West Texas Gathering System from Chevron Pipe Line Company for approximately $36.0 million, including transaction costs. Financing for the amounts paid at closing was provided by a draw under a previous credit facility. The assets acquired include approximately 420 miles of crude oil mainlines, approximately 295 miles of associated gathering and lateral lines, and approximately 2.9 million barrels of tankage located along the system.

Scurlock Permian

In May 1999, we completed the acquisition of Scurlock Permian LLC ("Scurlock") and certain other pipeline assets from Marathon Ashland Petroleum LLC. Including working capital adjustments and closing and financing costs, the cash purchase price was approximately $141.7 million. Financing for the acquisition was provided through $117.0 million of borrowings and the sale of 1.3 million Class B Common Units to our former general partner for total cash consideration of $25.0 million.

Scurlock, previously a wholly owned subsidiary of Marathon Ashland Petroleum, was engaged in crude oil transportation, gathering and marketing. The assets acquired included approximately 2,300 miles of active pipelines, numerous storage terminals and a fleet of trucks. The largest asset consisted of an approximately 920-mile pipeline and gathering system located in the Spraberry Trend in West Texas that extends into Andrews, Glasscock, Martin, Midland, Regan and Upton Counties, Texas. The assets we acquired also included approximately one million barrels of crude oil linefill.

Ongoing Acquisition Activities

Consistent with our business strategy, we are continuously engaged in discussions with potential sellers regarding the possible purchase by us of midstream crude oil assets. Such acquisition efforts involve participation by us in processes that have been made public, involve a number of potential buyers and are commonly referred to as "auction" processes, as well as situations where we believe we are the only party or one of a very limited number of potential buyers in negotiations with the potential seller. In connection with these activities, we routinely incur third party costs, which are capitalized and deferred pending final outcome of the transaction. Deferred costs associated with successful transactions are capitalized as part of the transaction, while deferred costs associated with unsuccessful transactions are expensed at the time of such final determination. We can give you no assurance that our current or future acquisition efforts will be successful or that any such acquisition will be completed on terms considered favorable to us.

All American Pipeline Linefill Sale and Asset Disposition

In March 2000, we sold to a unit of El Paso Corporation for $129.0 million the segment of the All American Pipeline that extends from Emidio, California to McCamey, Texas. Except for minor third party volumes, one of our subsidiaries, Plains Marketing, L.P., was the sole shipper on this segment of the pipeline since its predecessor acquired the line from the Goodyear Tire & Rubber Company in July 1998. We realized net proceeds of approximately $124.0 million after the associated transaction costs and estimated costs to remove equipment. We used the proceeds from the sale to reduce outstanding debt. We recognized a gain of approximately $20.1 million in connection with the sale.

We had suspended shipments of crude oil on this segment of the pipeline in November 1999. At that time, we owned approximately 5.2 million barrels of crude oil in the segment of the pipeline. We sold this crude oil from November 1999 to February 2000 for net proceeds of approximately $100.0 million, which were used for working capital purposes. We recognized an aggregate gain of approximately $44.6 million, of which approximately $28.1 million was recognized in 2000 in connection with the sale of the linefill.

Description of Segments and Associated Assets

Our business activities are conducted through two primary segments, Pipeline Operations, which for the year ended 2002 comprised approximately 55% of our Earnings Before Interest, Taxes, Depreciation and Amortization (“EBITDA”), and Gathering, Marketing, Terminalling and Storage Operations, which comprised the remaining 45%. Our operations are conducted in approximately 40 states in the United States and three provinces in Canada. The majority of our operations are conducted in Texas, Oklahoma, California, Louisiana and in the Canadian provinces of Alberta and Saskatchewan.

Following is a description of the activities and assets for each of our business segments:

Pipeline Operations

We own and operate over 5,600 miles of gathering and mainline crude oil pipelines located throughout the United States and Canada. Our activities from pipeline operations generally consist of transporting crude oil for a fee, third party leases of pipeline capacity, barrel exchanges and buy/sell arrangements.

Substantially all of our pipeline systems are operated from one of two central control rooms with computer systems designed to continuously monitor real-time operational data, including measurement of crude oil quantities injected in and delivered through the pipelines, product flow rates and pressure and temperature variations. This monitoring and measurement technology allows us to efficiently batch differing crude oil types with varying characteristics through the pipeline systems. The systems are designed to enhance leak detection capabilities, sound automatic alarms in the event of operational conditions outside of pre-established parameters and provide for remote-controlled shut-down of pump stations on the pipeline systems. Pump stations, storage facilities and meter measurement points along the pipeline systems are linked by telephone, microwave, satellite or radio communication systems for remote monitoring and control, which reduces our requirement for full-time site personnel at most of these locations.

We perform scheduled maintenance on all of our pipeline systems and make repairs and replacements when necessary or appropriate. We attempt to control corrosion of the mainlines through the use of corrosion inhibiting chemicals injected into the crude stream, external coatings and anode bed based or impressed current cathodic protection systems. Maintenance facilities containing equipment for pipe repairs, spare parts and trained response personnel are strategically located along the pipelines and in concentrated operating areas. We believe that all of our pipelines have been constructed and are maintained in all material respects in accordance with applicable federal, state and local laws and regulations, standards prescribed by the American Petroleum Institute and accepted industry practice. See “—Regulation—Pipeline and Storage Regulation.”

Following is a description of our major pipeline assets in the United States and Canada, grouped by geographic location:

Pipeline Assets

Southwest U.S.

Basin Pipeline System. The Basin System, acquired in the Shell acquisition, is a 514-mile mainline, telescoping crude oil system with a capacity ranging from approximately 144,000 barrels per day to 394,000 barrels per day depending on the segment. System throughput (as measured by system deliveries) was approximately 221,000 barrels per day (net to our interest) from the acquisition date to the end of 2002. The Basin System consists of three primary movements of crude oil: (1) barrels are shipped from Jal, New Mexico to the West Texas markets of Wink and Midland, where they are exchanged and/or further shipped to refining centers; (2) barrels are shipped by refiners to the Mid-Continent region on the Midland to Wichita Falls segment and the Wichita Falls to Cushing segment; and (3) foreign and Gulf of Mexico barrels are delivered into Basin at Wichita Falls and shipped to Cushing for further distribution to Mid-Continent or Midwest refineries. The size of the pipe ranges from 20 to 24 inches in diameter. The Basin system also includes approximately 5.8 million barrels (5.0 million barrels, net to our interest) of crude oil storage capacity located along the system. Our ownership interest in the system is approximately 87%. TEPPCO Partners, L.P. owns the remaining interest in the system. The Basin system is subject to tariff rates regulated by the Federal Energy Regulatory Commission (the "FERC"). See "—Regulation—Transportation Regulation."

West Texas Gathering System. The West Texas Gathering System is a common carrier crude oil pipeline system located in the heart of the Permian Basin producing area, and includes approximately 420 miles of crude oil mainlines and approximately 295 miles of associated gathering and lateral lines. The West Texas Gathering System has the capability to transport approximately 190,000 barrels per day. Total system volumes were approximately 78,000 barrels per day in 2002. Chevron USA has agreed to transport its equity crude oil production from fields connected to the West Texas Gathering System on the system through July 2011 (representing approximately 20,000 barrels per day, or 26% of the total system volumes during 2002). The system also includes approximately 2.9 million barrels of crude oil storage capacity, located primarily in Monahans, Midland, Wink and Crane, Texas.

Permian Basin Gathering System. The Permian Basin System, acquired in the Shell acquisition, is comprised of approximately 17 gathering systems and nine trunk lines with connecting injection stations and storage facilities. In total, the system consists of 927 miles of pipe and primarily transports crude oil from wells in the Permian Basin to the Basin System. The Permian Basin System gathered approximately 62,000 barrels per day from the acquisition date to the end of 2002. The Permian Basin System includes approximately 3.2 million barrels of crude oil storage capacity.

Spraberry Pipeline System. The Spraberry Pipeline System, acquired in the Scurlock acquisition, gathers crude oil from the Spraberry Trend of West Texas and transports it to Midland, Texas, where it interconnects with the West Texas Gathering System and other pipelines. The Spraberry Pipeline System consists of approximately 920 miles of pipe of varying diameter, and has a throughput capacity of approximately 50,000 barrels of crude oil per day. The Spraberry Trend is one of the largest producing areas in West Texas, and we are one of the largest gatherers in the Spraberry Trend. For the year ended December 31, 2002, the Spraberry Pipeline System gathered approximately 35,000 barrels per day of crude oil. The Spraberry Pipeline System also includes approximately 364,000 barrels of tank capacity located along the pipeline.

Rancho Pipeline System. The Rancho System, acquired in the Shell acquisition, is a 24-inch, 458-mile mainline crude oil system with a capacity of approximately 187,000 barrels per day. During 2002, the system operated at approximately 50% of capacity. We operate the Rancho System which transports crude oil from McCamey, Texas, to the Houston Ship Channel where it connects to the Houston refining complex. The Rancho System includes approximately 1.2 million barrels of crude oil storage capacity (0.7 million barrels, net to our interest). Our ownership interest in the system ranges from approximately 46% to 59% depending upon the segment. The remaining interests in the system are owned by BP Amoco, Marathon Ashland, Crown Central and TEPPCO. The Rancho Pipeline System Agreement dated November 1, 1951, pursuant to which the system was constructed and operated, terminates in March 2003. Upon termination, the agreement requires the owners to take the pipeline system out of service. Accordingly, we have notified our shippers that we will not accept nominations for movements after February 28, 2003. As contemplated at the time of the Shell acquisition, plans are currently under way to purge and idle portions of the pipeline system subject to final determination of the disposition of the system. During 2001, total volumes shipped from West Texas to the Houston Ship Channel on the Rancho system approximated 83,000 barrels per day. These volumes averaged approximately 91,000 barrels per day from the acquisition date to the end of 2002. Once the Rancho System is shut down, these volumes become candidates for shipment on the Basin System.

Dollarhide Pipeline System. The Dollarhide Pipeline System, acquired from Unocal Pipeline Company in October 2001, is a common carrier pipeline system that is located in West Texas. In 2002, the Dollarhide Pipeline

System delivered approximately 6,000 barrels of crude oil per day into the West Texas Gathering System. The system also includes approximately 55,000 barrels of crude oil storage capacity along the system and in Midland.

Western U.S.

All American Pipeline System. The segment of the All American Pipeline that we retained following the sale of the line segment to El Paso is a common carrier crude oil pipeline system that transports crude oil produced from certain outer continental shelf, or OCS, fields offshore California to locations in California. See "—Major Acquisitions and Dispositions—All American Pipeline Linefill Sale and Asset Disposition." This segment is subject to tariff rates regulated by the FERC.

We own and operate the segment of the system that extends approximately 10 miles along the California coast from Las Flores to Gaviota (24-inch diameter pipe) and continues from Gaviota approximately 130 miles to our station in Emidio, California (30-inch pipe). Between Gaviota and our Emidio Station, the All American Pipeline interconnects with our San Joaquin Valley, or SJV, Gathering System as well as various third party intrastate pipelines, including the Unocap Pipeline System, the Equilon Pipeline System and the Pacific Pipeline.

The All American Pipeline currently transports OCS crude oil received at the onshore facilities of the Santa Ynez field at Las Flores and the onshore facilities of the Point Arguello field located at Gaviota. ExxonMobil, which owns all of the Santa Ynez production, and Plains Exploration and Production Company ("PXP") and other producers, which together own approximately 75% of the Point Arguello production, have entered into transportation agreements committing to transport all of their production from these fields on the All American Pipeline. These agreements, which expire in August 2007, provide for a minimum tariff with annual escalations based on specific composite indices. The producers from the Point Arguello field who do not have contracts with us have no other means of transporting their production and, therefore, ship their volumes on the All American Pipeline at the posted tariffs. Volumes attributable to PXP are purchased and sold to a third party under our marketing agreement with PXP before such volumes enter the All American Pipeline. See Item 13. "Certain Relationships and Related Transactions—Transactions with Related Parties—General." The third party pays the same tariff as required in the transportation agreements. At December 31, 2002, the tariffs averaged $1.71 per barrel. The agreements do not require these owners to transport a minimum volume. A significant portion of our gross margin is derived from pipeline transportation margins associated with these two fields. For the year ended December 31, 2002, approximately $30 million, or 17%, of our gross margin was attributable to the Santa Ynez field and approximately $9 million, or 5% was attributable to the Point Arguello field.

The relative contribution to our gross margin from these fields has decreased from approximately 46% in the second half of 1998 to 22% in 2002, as the Partnership has grown and diversified through acquisitions and organic expansions and as a result of declines in volumes produced and transported from these fields, offset somewhat by an increase in pipeline tariffs. Over the last several years, transportation volumes received from the Santa Ynez and Point Arguello fields have declined from 92,000 and 60,000 average daily barrels, respectively, in 1995 to 50,000 and 16,000 average daily barrels, respectively, for the year ended December 31, 2002. We expect that there will continue to be natural production declines from each of these fields as the underlying reservoirs are depleted. A 5,000 barrel per day decline in volumes shipped from these fields would result in a decrease in annual pipeline tariff revenues of approximately $3.1 million, based on an annual tariff of $1.71 per barrel.

The table below sets forth the historical volumes received from both of these fields for the past five years.

	Year Ended December 31,				
	2002	2001	2000	1999	1998
	(barrels in thousands)				
Average daily volumes received from:					
Port Arguello (at Gaviota)	16	18	18	20	26
Santa Ynez (at Las Flores)	50	51	56	59	68
Total	66	69	74	79	94

SJV Gathering System. The SJV Gathering System is connected to most of the major fields in the San Joaquin Valley. The SJV Gathering System was constructed in 1987 with a design capacity of approximately 140,000 barrels per day. The system consists of a 16-inch pipeline that originates at the Belridge station and extends 45 miles south to a connection with the All American Pipeline at the Pentland station. The SJV Gathering System also includes approximately 600,000 barrels of tank capacity, which can be used to facilitate movements along the system as well as to support our other activities.

The table below sets forth the historical volumes received into the SJV Gathering System for the past five years.

	Year Ended December 31,				
	2002	2001	2000	1999	1998
	(barrels in thousands)				
Total average daily volumes	73	61	60	84	85

Butte Pipeline System. We own an approximate 22% equity interest in Butte Pipe Line Company, which in turn owns the Butte Pipeline System, a 373-mile mainline system that runs from Baker, Montana to Guernsey, Wyoming. The Butte Pipeline System is connected to the Poplar Pipeline System, which in turn is connected to the Wascana Pipeline System, which is located in our Canadian Region and is wholly owned by us. The total system volumes for Butte Pipeline System during 2002 were approximately 71,000 barrels of crude oil per day (approximately 16,000 barrels per day, net to our 22% interest).

U.S. Gulf Coast

Sabine Pass Pipeline System. The Sabine Pass Pipeline System, acquired in the Scurlock acquisition, is a common carrier crude oil pipeline system. The primary purpose of the Sabine Pass Pipeline System is to gather crude oil from onshore facilities of offshore production near Johnson's Bayou, Louisiana, and deliver it to tankage and barge loading facilities in Sabine Pass, Texas. The Sabine Pass Pipeline System consists of approximately 35 miles of pipe ranging from 4 to 10 inches in diameter and has a throughput capacity of approximately 26,000 barrels of crude oil per day. In 2002, the system transported approximately 19,000 barrels of crude oil per day. The Sabine Pass Pipeline System also includes 245,000 barrels of tank capacity located along the pipeline.

Ferriday Pipeline System. The Ferriday Pipeline System, acquired in the Scurlock acquisition, is a common carrier crude oil pipeline system located in eastern Louisiana and western Mississippi. The Ferriday Pipeline System consists of approximately 570 miles of pipe ranging from 2 inches to 12 inches in diameter. In 2002, the Ferriday Pipeline System delivered approximately 9,000 barrels of crude oil per day to third party pipelines that supplied refiners in the Midwest. The Ferriday Pipeline System also includes approximately 332,000 barrels of tank capacity located along the pipeline.

East Texas Pipeline System. The East Texas Pipeline System, acquired in the Scurlock acquisition, is a proprietary crude oil pipeline system that in 2002 gathered approximately 20,000 barrels per day of crude oil in East Texas and transported approximately 24,000 barrels of crude oil per day to Crown Central's refinery in Longview, Texas. Crown Central's deliveries are subject to a throughput and deficiency agreement, which extends through 2004. The East Texas Pipeline System also includes approximately 266,000 barrels of tank capacity located along the pipeline.

Red River Pipeline System. The Red River Pipeline System, acquired in 2003, is a 347-mile crude oil pipeline system that originates at Sabine in East Texas, and terminates near Cushing, Oklahoma. The Red River system has a capacity of up to 22,000 barrels of crude oil per day, depending upon the type of crude oil being transported. During 2002, the system transported approximately 8,000 barrels of crude oil per day while being operated by BP. The system also includes approximately 695,000 barrels of crude oil storage capacity. In 2003, we intend to connect the pipeline system to our Cushing Terminal.

Central U.S.

Illinois Basin Pipeline System. The Illinois Basin Pipeline System, acquired with the Scurlock acquisition, consists of common carrier pipeline and gathering systems and truck injection facilities in southern Illinois. The Illinois Basin Pipeline System consists of approximately 80 miles of pipe of varying diameter and in 2002 delivered approximately 3,500 barrels of crude oil per day to third party pipelines that supply refiners in the Midwest. For the year ended December 31, 2002, approximately 3,000 barrels of crude oil per day of the supply on this system came from fields operated by PXP, formerly Plains Resources.

Canada

Manito Pipeline System. The Manito Pipeline System, acquired in the Murphy acquisition, is a provincially regulated system located in Saskatchewan, Canada. The Manito Pipeline System is a 101-mile crude oil pipeline and a parallel 101-mile condensate pipeline that connects the North Saskatchewan Pipeline System and multiple gathering lines to the Enbridge system at Kerrobert. The Manito Pipeline System volumes were approximately 66,000 barrels of crude oil and condensate per day in 2002.

Milk River Pipeline System. The Milk River Pipeline System, acquired in the Murphy acquisition, is a National Energy Board ("NEB") regulated system located in Alberta, Canada. The Milk River Pipeline System consists of three parallel 11-mile crude oil pipelines that connect the Bow River Pipeline in Alberta to the Cenex Pipeline at the United States border. The Milk River Pipeline System transported approximately 97,000 barrels of crude oil per day in 2002.

North Saskatchewan Pipeline System. The North Saskatchewan Pipeline System, acquired in the Murphy acquisition, is a provincially regulated system located in Saskatchewan, Canada. We operate the North Saskatchewan Pipeline System, which is a 34-mile crude oil pipeline and a parallel 34-mile condensate pipeline that connects to the Manito Pipeline at Dulwich. In 2002, the North Saskatchewan Pipeline System delivered approximately 6,000 barrels of crude oil and condensate per day into the Manito Pipeline. Our ownership interest in the North Saskatchewan Pipeline System is approximately 36%.

Cactus Lake/Bodo Pipeline System. The Cactus Lake/Bodo Pipeline System, acquired in the Murphy acquisition, is located in Alberta and Saskatchewan, Canada. The Bodo portion of the system is NEB-regulated, and the remainder is provincially regulated. We operate the Cactus Lake/Bodo Pipeline System, which is a 55-mile crude oil pipeline and a parallel 55-mile condensate pipeline that connects to our storage and terminalling facility at Kerrobert. In 2002, the Cactus Lake/Bodo Pipeline System transported approximately 26,000 barrels per day of crude oil and condensate. Our ownership interest in the Cactus Lake segment is 13.125% and our ownership interest in the Bodo Pipeline is 76.25%. We own various interests in the lateral lines in these systems.

Wascana Pipeline System. The Wascana Pipeline System, acquired in the Murphy acquisition, is an NEB-regulated system located in Saskatchewan, Canada. The Wascana Pipeline System is a 107-mile crude oil pipeline that connects to the Shell Pipeline system at the United States border near Raymond, Montana. In 2002, the Wascana Pipeline System transported approximately 10,000 barrels of crude oil per day.

Wapella Pipeline System. The Wapella Pipeline System is an approximately 79 mile, NEB-regulated system located in southeastern Saskatchewan and southwestern Manitoba. In 2002, the Wapella Pipeline System delivered approximately 10,000 barrels of crude oil per day to the Enbridge Pipeline at Cromer, Manitoba. The system also includes approximately 18,500 barrels of crude oil storage capacity.

Gathering, Marketing, Terminalling and Storage Operations

The combination of our gathering and marketing operations and our terminalling and storage operations provides a counter-cyclical balance that has a stabilizing effect on our operations and cash flow. The strategic use of our terminalling and storage assets in conjunction with our gathering and marketing operations provides us with the flexibility to optimize margins irrespective of whether a strong or weak market exists. Following is a description of our activities with respect to this segment.

Gathering and Marketing Operations

Crude Oil. The majority of our gathering and marketing activities are in the geographic locations previously discussed. These activities include:

- purchasing crude oil from producers at the wellhead and in bulk from aggregators at major pipeline interconnects and trading locations;

- transporting this crude oil on our own proprietary gathering assets or, when necessary or cost effective, assets owned and operated by third parties;

- exchanging this crude oil for another grade of crude oil or at a different geographic location, as appropriate, in order to maximize margins or meet contract delivery requirements; and

- marketing crude oil to refiners or other resellers.

We purchase crude oil from many independent producers and believe that we have established broad-based relationships with crude oil producers in our areas of operations. Gathering and marketing activities involve relatively large volumes of transactions with lower margins compared to pipeline and terminalling and storage operations.

The following table shows the average daily volume of our lease gathering and bulk purchases from 1998 through 2002:

	Year Ended December 31,				
	2002	2001	2000	1999	1998
	(barrels in thousands)				
Lease gathering purchases[1]	410	348	262	265	88
Bulk purchases[1]	80	46	28	138	98
Total volumes	490	394	290	403	186

(1) Prior period volume amounts have been adjusted (i) so that volumes associated with acquisitions represent weighted average daily amounts during the year of acquisition, and (ii) for consistency of comparison between years.

Crude Oil Purchases. We purchase crude oil from producers under contracts that range in term from a thirty-day evergreen to three years. In a typical producer's operation, crude oil flows from the wellhead to a separator where the petroleum gases are removed. After separation, the crude oil is treated to remove water, sand and other contaminants and is then moved into the producer's on-site storage tanks. When the tank is full, the producer contacts our field personnel to purchase and transport the crude oil to market. We utilize our truck fleet and gathering pipelines and third party pipelines, trucks and barges to transport the crude oil to market. We own or lease approximately 300 trucks used for gathering crude oil.

We have a marketing agreement with Plains Resources, under which we are the exclusive marketer and purchaser for all of Plains Resources' equity crude oil production (including its subsidiaries that conduct exploration and production activities.) The marketing agreement provides that we will purchase for resale at market prices all of Plains Resources' equity crude oil production, for which we charge a fee of $0.20 per barrel. This fee will be adjusted every three years based upon then existing market conditions. The marketing agreement will terminate upon a "change of control" of Plains Resources or our general partner. In November 2001, the marketing agreement automatically extended for an additional three-year period. On December 18, 2002, Plains Resources completed a spin-off of one of its subsidiaries, PXP, to its shareholders. PXP is a successor participant to this marketing agreement. See Item 13. "Certain Relationships and Related Transactions—Transactions with Related Parties—General."

Bulk Purchases. In addition to purchasing crude oil at the wellhead from producers, we purchase crude oil in bulk at major pipeline terminal locations. This oil is transported from the wellhead to the pipeline by major oil companies, large independent producers or other gathering and marketing companies. We purchase crude oil in bulk when we believe additional opportunities exist to realize margins further downstream in the crude oil distribution chain. The opportunities to earn additional margins vary over time with changing market conditions. Accordingly, the margins associated with our bulk purchases will fluctuate from period to period.

Crude Oil Sales. The marketing of crude oil is complex and requires detailed current knowledge of crude oil sources and end markets and a familiarity with a number of factors including grades of crude oil, individual refinery demand for specific grades of crude oil, area market price structures for the different grades of crude oil, location of customers, availability of transportation facilities and timing and costs (including storage) involved in delivering crude oil to the appropriate customer. We sell our crude oil to major integrated oil companies, independent refiners and other resellers in various types of sale and exchange transactions, at market prices for terms ranging from one month to three years.

We establish a margin for crude oil we purchase by selling crude oil for physical delivery to third party users, such as independent refiners or major oil companies, or by entering into a future delivery obligation with respect to futures contracts on the NYMEX and over-the-counter. Through these transactions, we seek to maintain a position that is substantially balanced between crude oil purchases and sales and future delivery obligations. From time to time, we enter into various types of sale and exchange transactions including fixed price delivery contracts, floating price collar arrangements, financial swaps and crude oil futures contracts as hedging devices. Except for pre-defined inventory positions, our policy is generally to purchase only crude oil for which we have a market, to structure our sales contracts so that crude oil price fluctuations do not materially affect the gross margin we receive, and to not acquire and hold crude oil, futures contracts or other derivative products for the purpose of speculating on crude oil price changes that might expose us to indeterminable losses. See "Crude Oil Volatility; Counter-Cyclical Balance; Risk Management." In November 1999, we discovered that this policy was violated, and we incurred $174.0 million in unauthorized trading losses, including estimated associated costs and legal expenses. In 2000, we recognized an additional $7.0 million charge related to the settlement of litigation for an amount in excess of established reserves. See "—Unauthorized Trading Losses."

Crude Oil Exchanges. We pursue exchange opportunities to enhance margins throughout the gathering and marketing process. When opportunities arise to increase our margin or to acquire a grade of crude oil that more closely matches our physical delivery requirement or the preferences of our refinery customers, we exchange physical crude oil with third parties. These exchanges are effected through contracts called exchange or buy-sell agreements. Through an exchange agreement, we agree to buy crude oil that differs in terms of geographic location, grade of crude oil or physical delivery schedule from crude oil we have available for sale. Generally, we enter into exchanges to acquire crude oil at locations that are closer to our end markets, thereby reducing transportation costs and increasing our margin. We also exchange our crude oil to be physically delivered at a later date, if the exchange is expected to result in a higher margin net of storage costs, and enter into exchanges based on the grade of crude oil, which includes such factors as sulfur content and specific gravity, in order to meet the quality specifications of our physical delivery contracts.

Producer Services. Crude oil purchasers who buy from producers compete on the basis of competitive prices and highly responsive services. Through our team of crude oil purchasing representatives, we maintain ongoing relationships with producers in the United States and Canada. We believe that our ability to offer high-quality field and administrative services to producers is a key factor in our ability to maintain volumes of purchased crude oil and to obtain new volumes. Field services include efficient gathering capabilities, availability of trucks, willingness to construct gathering pipelines where economically justified, timely pickup of crude oil from tank batteries at the lease or production point, accurate measurement of crude oil volumes received, avoidance of spills and effective management of pipeline deliveries. Accounting and other administrative services include securing division orders (statements from interest owners affirming the division of ownership in crude oil purchased by us), providing statements of the crude oil purchased each month, disbursing production proceeds to interest owners, and calculation and payment of ad valorem and production taxes on behalf of interest owners. In order to compete effectively, we must maintain records of title and division order interests in an accurate and timely manner for purposes of making prompt and correct payment of crude oil production proceeds, together with the correct payment of all severance and production taxes associated with such proceeds.

Liquefied Petroleum Gas and Other Petroleum Products. We also gather and market LPG and other petroleum products throughout the United States and Canada, concentrated primarily in Washington, California, Kansas, Michigan, Texas, Montana, Nebraska and the Canadian provinces of Alberta and Ontario. These activities include:

- purchasing LPG (primarily propane and butane) from producers at gas plants and in bulk at major pipeline terminal points and storage locations;

- transporting the LPG via common carrier pipelines, railcars and trucks to our own terminals and third party facilities for subsequent resale by them to retailers and other wholesale customers; and

- exchanging product to other locations to maximize margins and/or to meet contract delivery requirements.

We purchase LPG from numerous producers and have established long-term, broad-based relationships with LPG producers in our areas of operation. We purchase LPG directly from gas plants, major pipeline terminals and storage locations. Gathering and marketing activities for LPG typically consist of smaller volumes and generally higher margin per barrel transactions relative to crude oil.

LPG Purchases. We purchase LPG from producers, refiners, and other LPG marketing companies under contracts that range from immediate delivery to one year in term. In a typical producer’s or refiner’s operation, LPG that is produced at the gas plant or refinery is fractionated into various components including propane and butane and then purchased by us for movement via tank truck, railcar or pipeline.

In addition to purchasing LPG at gas plants or refineries, we also purchase LPG in bulk at major pipeline terminal points and storage facilities from major oil companies, large independent producers or other LPG marketing companies. We purchase LPG in bulk when we believe additional opportunities exist to realize margins further downstream in our LPG distribution chain. The opportunities to earn additional margins vary over time with changing market conditions. Accordingly, the margins associated with our bulk purchases will fluctuate from period to period.

LPG Sales. The marketing of LPG is complex and requires detailed current knowledge of LPG sources and end markets and a familiarity with a number of factors including the various modes and availability of transportation, area market prices and timing and costs of delivering LPG to customers.

We sell LPG primarily to industrial end users and retailers, and limited volumes to other marketers. Propane is sold to small independent retailers who then transport the product via bobtail truck to residential consumers for home heating and to some light industrial users such as forklift operators. Butane is used by refiners for gasoline blending and as a diluent for the movement of conventional heavy oil production. Butane demand for use as heavy oil diluent has increased as supplies of Canadian condensate have declined.

We establish a margin for propane by transporting it in bulk, via various transportation modes, to our controlled terminals where we deliver the propane to our retailer customers for subsequent delivery to their individual heating customers. We also create margin by selling propane for future physical delivery to third party users, such as retailers and industrial users. Through these transactions, we seek to maintain a position that is substantially balanced between propane purchases and sales and future delivery obligations. From time to time, we enter into various types of sale and exchange transactions including floating price collar arrangements, financial swaps and crude oil and LPG-related futures contracts as hedging devices. Except for pre-defined inventory positions, our policy is generally to purchase only LPG for which we have a market, and to structure our sales contracts so that LPG spot price fluctuations do not materially affect the gross margin we receive. Margin is created on the butane purchased by delivering large volumes during the short refinery blending season through the use of our extensive leased railcar fleet and the use of third party storage facilities. We also create margin on butane by capturing the difference in price between condensate and butane when butane is used to replace condensate as a diluent for the movement of Canadian heavy oil production. While we seek to maintain a position that is substantially balanced within our LPG activities, as a result of production, transportation and delivery variances as well as logistical issues associated with inclement weather conditions, from time to time we experience net unbalanced positions for short periods of time. In connection with managing these positions and maintaining a constant presence in the marketplace, both necessary for our core business, our policies provide that any net imbalance may not exceed 200,000 barrels. These activities are monitored independently by our risk management function and must take place within predefined limits and authorizations.

LPG Exchanges. We pursue exchange opportunities to enhance margins throughout the gathering and marketing process. When opportunities arise to increase our margin or to acquire a volume of LPG that more closely matches our physical delivery requirement or the preferences of our customers, we exchange physical LPG with third parties. These exchanges are effected through contracts called exchange or buy-sell agreements. Through an exchange agreement, we agree to buy LPG that differs in terms of geographic location, type of LPG or physical delivery schedule from LPG we have available for sale. Generally, we enter into exchanges to acquire LPG at locations that are closer to our end markets in order to meet the delivery specifications of our physical delivery contracts.

Credit. Our merchant activities involve the purchase of crude oil for resale and require significant extensions of credit by our suppliers of crude oil. In order to assure our ability to perform our obligations under crude oil purchase agreements, various credit arrangements are negotiated with our crude oil suppliers. Such arrangements include open lines of credit directly with us, and standby letters of credit issued under our letter of credit facility.

When we market crude oil, we must determine the amount, if any, of the line of credit to be extended to any given customer. We manage our exposure to credit risk through credit analysis, credit approvals, credit limits and monitoring procedures. If we determine that a customer should receive a credit line, we must then decide on the amount of credit that should be extended. Since our typical sales transactions can involve tens of thousands of barrels of crude oil, the risk of nonpayment and nonperformance by customers is a major consideration in our business. We believe our sales are made to creditworthy entities or entities with adequate credit support.

We also have credit risk with respect to our sales of LPG; however, because our sales are typically in relatively small amounts to individual customers, we do not believe that we have material concentration of credit risk. Typically, we enter into annual contracts to sell LPG on a forward basis, as well as sell LPG on a current basis to local distributors and retailers. In certain cases our customers prepay for their purchases, in amounts ranging from

$0.05 per gallon to 100% of their contracted amounts. Generally, sales of LPG are settled within 30 days of the date of invoice.

During 2002, announcements of business failures, revelations of material misrepresentations and related financial restatements adversely affected several companies within the energy industry, resulting in a rapid deterioration in credit ratings. See Item 7. “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Contingencies—Recent Disruptions in Industry Credit Markets.”

Terminalling and Storage Operations

We own approximately 22.7 million barrels of terminalling and storage assets, including tankage associated with our pipeline and gathering systems. Our storage and terminalling operations increase our margins in our business of purchasing and selling crude oil and also generate revenue through a combination of storage and throughput charges to third parties. Storage fees are generated when we lease tank capacity to third parties. Terminalling fees, also referred to as throughput fees, are generated when we receive crude oil from one connecting pipeline and redeliver crude oil to another connecting carrier in volumes that allow the refinery to receive its crude oil on a ratable basis throughout a delivery period. Both terminalling and storage fees are generally earned from:

- refiners and gatherers that segregate or custom blend crudes for refining feedstocks;
- pipeline operators, refiners or traders that need segregated tankage for foreign cargoes;
- traders who make or take delivery under NYMEX contracts; and
- producers and resellers that seek to increase their marketing alternatives.

The tankage that is used to support our arbitrage activities positions us to capture margins in a contango market (when the oil prices for future deliveries are higher than the current prices) or when the market switches from contango to backwardation (when the oil prices for future deliveries are lower than the current prices). See "—Crude Oil Volatility; Counter-Cyclical Balance; Risk Management."

Our most significant terminalling and storage asset is our Cushing Terminal located at the Cushing Interchange. The Cushing Interchange is one of the largest wet-barrel trading hubs in the U.S. and the delivery point for crude oil futures contracts traded on the NYMEX. The Cushing Terminal has been designated by the NYMEX as an approved delivery location for crude oil delivered under the NYMEX light sweet crude oil futures contract. As the NYMEX delivery point and a cash market hub, the Cushing Interchange serves as a primary source of refinery feedstock for the Midwest refiners and plays an integral role in establishing and maintaining markets for many varieties of foreign and domestic crude oil. Our Cushing Terminal was constructed in 1993 to capitalize on the crude oil supply and demand imbalance in the Midwest. The Cushing Terminal is also used to support and enhance the margins associated with our merchant activities relating to our lease gathering and bulk purchasing activities. See "—Gathering and Marketing Operations—Bulk Purchases." In 1999, we completed our 1.1 million barrel Phase I expansion project, which increased the facility's total storage capacity to 3.1 million barrels. On July 1, 2002, we placed in service approximately 1.1 million barrels of tank capacity associated with our Phase II expansion of the Cushing Terminal, raising the facility's total storage capacity to approximately 4.2 million barrels. In January 2003, we placed in service our 1.1 million barrel Phase III expansion. The Phase II and III expansions increased the capacity of the Cushing Terminal by approximately 70% to a total of approximately 5.3 million barrels. The Cushing Terminal now consists of fourteen 100,000-barrel tanks, four 150,000-barrel tanks and twelve 270,000-barrel tanks, all of which are used to store and terminal crude oil. The Cushing Terminal also includes a pipeline manifold and pumping system that has an estimated throughput capacity of approximately 800,000 barrels per day. The Cushing Terminal is connected to the major pipelines and other terminals in the Cushing Interchange through pipelines that range in size from 10 inches to 24 inches in diameter.

The Cushing Terminal is designed to serve the needs of refiners in the Midwest. In order to service an expected increase in the volumes as well as the varieties of foreign and domestic crude oil projected to be transported through the Cushing Interchange, we incorporated certain attributes into the design of the Cushing Terminal including:

- multiple, smaller tanks to facilitate simultaneous handling of multiple crude varieties in accordance with normal pipeline batch sizes;
- dual header systems connecting most tanks to the main manifold system to facilitate efficient switching between crude grades with minimal contamination;
- bottom drawn sumps that enable each tank to be efficiently drained down to minimal remaining volumes to minimize crude oil contamination and maintain crude oil integrity during changes of service;
- mixer(s) on each tank to facilitate blending crude oil grades to refinery specifications; and
- a manifold and pump system that allows for receipts and deliveries with connecting carriers at their maximum operating capacity.

As a result of incorporating these attributes into the design of the Cushing Terminal, we believe we are favorably positioned to serve the needs of Midwest refiners to handle an increase in the number of varieties of crude oil transported through the Cushing Interchange. The pipeline manifold and pumping system of our Cushing Terminal is designed to support more than 10 million barrels of tank capacity and we have sufficient land holdings in and around the Cushing Interchange on which to construct additional tankage. Our tankage in Cushing ranges in age from brand new to approximately 10 years old and the average age is approximately 4.7 years old. In contrast, we estimate that of the approximately 21 million barrels of remaining tanks in Cushing owned by third parties, the average age is approximately 50 years and of that, approximately 9 million barrels has an average age of over 70 years. We believe that provides us with a competitive advantage over our competitors. In addition, we believe that we are well positioned to accommodate construction of replacement tankage that may be required as a result of the imposition of stricter regulatory standards and related attrition among our competitors’ tanks in connection with the requirements of API 653. See “—Regulation—Pipeline and Storage Regulation.”

Our Cushing Terminal also incorporates numerous environmental and operational safeguards. We believe that our terminal is the only one at the Cushing Interchange in which each tank has a secondary liner (the equivalent of double bottoms), leak detection devices and secondary seals. The Cushing Terminal is the only terminal at the Cushing Interchange equipped with aboveground pipelines. Like the pipeline systems we operate, the Cushing Terminal is operated by a computer system designed to monitor real-time operational data and each tank is cathodically protected. In addition, each tank is equipped with an audible and visual high-level alarm system to prevent overflows; a double seal floating roof designed to minimize air emissions and prevent the possible accumulation of potentially flammable gases between fluid levels and the roof of the tank; and a foam dispersal system that, in the event of a fire, is fed by a fully-automated fire water distribution network.

The following table sets forth throughput volumes for our terminalling and storage operations and quantity of tankage leased to third parties for our Cushing Terminal from 1998 through 2002.

	Year Ended December 31,				
	2002	**2001**	**2000**	**1999**	**1998**
			(barrels in thousands)		
Throughput volumes (average daily volumes)	110	94	59	72	69
Storage leased to third parties (average monthly volumes)[1]	1,067	2,136	1,437	1,743	890

(1) The level of tankage at Cushing that we allocate for our arbitrage activities (and therefore is not available for lease to third parties) varies throughout crude oil price cycles.

Crude Oil Volatility; Counter-Cyclical Balance; Risk Management

Crude oil prices have historically been very volatile and cyclical, with NYMEX benchmark prices ranging from as high as $40.00 per barrel to as low as $10.00 per barrel over the last 13 years. Gross margin from terminalling and storage activities is dependent on the throughput volume of crude oil stored, capacity leased to third parties, capacity that we use for our own activities, and the level of other fees generated at our terminalling and storage facilities. Gross margin from our gathering and marketing activities is dependent on our ability to sell crude oil at a price in excess of our aggregate cost. Although margins may be affected during transitional periods, these operations are not directly affected by the absolute level of crude oil prices, but are affected by overall levels of supply and demand for crude oil and relative fluctuations in market-related indices.

During periods when supply exceeds the demand for crude oil, the market for crude oil is often in contango, meaning that the price of crude oil for future deliveries is higher than current prices. A contango market has a generally negative impact on marketing margins, but is favorable to the storage business, because storage owners at major trading locations (such as the Cushing Interchange) can simultaneously purchase production at current prices for storage and sell at higher prices for future delivery.

When there is a higher demand than supply of crude oil in the near term, the market is backwardated, meaning that the price of crude oil for future deliveries is lower than current prices. A backwardated market has a positive impact on marketing margins because crude oil gatherers can capture a premium for prompt deliveries. In this environment, there is little incentive to store crude oil as current prices are above future delivery prices.

The periods between a backwardated market and a contango market are referred to as transition periods. Depending on the overall duration of these transition periods, how we have allocated our assets to particular strategies and the time length of our crude oil purchase and sale contracts and storage lease agreements, these transition periods may have either an adverse or beneficial affect on our aggregate gross margin. A prolonged transition from a backwardated market to a contango market, or vice versa (essentially a market that is neither in pronounced backwardation nor contango), represents the most difficult environment for our gathering, marketing, terminalling and storage activities. When the market is in contango, we will use our tankage to improve our gathering margins by storing crude oil we have purchased for delivery in future months that are selling at a higher price. In a backwardated market, we use and lease less storage capacity but increased marketing margins provide an offset to this reduced cash flow. We believe that the combination of our terminalling and storage activities and gathering and marketing activities provides a counter-cyclical balance that has a stabilizing effect on our operations and cash flow. References to counter-cyclical balance elsewhere in this report are referring to this relationship between our terminalling and storage activities and our gathering and marketing activities in transitioning crude oil markets.

As use of the financial markets for crude oil has increased by producers, refiners, utilities and trading entities, risk management strategies, including those involving price hedges using NYMEX futures contracts and derivatives, have become increasingly important in creating and maintaining margins. Such hedging techniques require significant resources dedicated to managing these positions. Our risk management policies and procedures are designed to monitor both NYMEX and over-the-counter positions and physical volumes, grades, locations and delivery schedules to ensure that our hedging activities are implemented in accordance with such policies. We have a risk management function that has direct responsibility and authority for our risk policies, our trading controls and procedures and certain other aspects of corporate risk management.

Our policy is to purchase only crude oil for which we have a market, and to structure our sales contracts so that crude oil price fluctuations do not materially affect the gross margin we receive. Except for inventory transactions not to exceed 500,000 barrels, we do not acquire and hold crude oil futures contracts or other derivative products for the purpose of speculating on crude oil price changes that might expose us to indeterminable losses.

As a result of production and delivery variances associated with our lease purchase activities, from time to time we experience net unbalanced positions. In connection with managing these positions and maintaining a constant presence in the marketplace, both necessary for our core business, we engage in this controlled trading program for up to 500,000 barrels. This activity is monitored independently by our risk management function and must take place within predefined limits and authorizations. In order to hedge margins involving our physical assets and manage risks associated with our crude oil purchase and sale obligations, we use derivative instruments, including regulated futures and options transactions, as well as over-the-counter instruments. In analyzing our risk management activities, we draw a distinction between enterprise-level risks and trading-related risks. Enterprise-level risks are those that underlie our core businesses and may be managed based on whether there is value in doing so. Conversely, trading-related risks (the risks involved in trading in the hopes of generating an increased return) are not inherent in the core business; rather, those risks arise as a result of engaging in the trading activity. We have a Risk Management Committee that approves all new risk management strategies through a formal process. With the partial exception of the limited 500,000-barrel program, our approved strategies are intended to mitigate enterprise-level risks that are inherent in our core businesses of crude oil gathering and marketing and storage. Similarly, while we seek to maintain a position that is substantially balanced within our LPG activities, as a result of production, transportation and delivery variances as well as logistical issues associated with inclement weather conditions, from time to time we experience net unbalanced positions for short periods of time. In connection with managing these positions and maintaining a constant presence in the marketplace, both necessary for our core business, our policies provide that any net imbalance may not exceed 200,000 barrels. These activities are monitored independently by our risk management function and must take place within predefined limits and authorizations.

Although the intent of our risk-management strategies is to hedge our margin, not all of our derivatives qualify for hedge accounting. In such instances, changes in the fair values of these derivatives will receive mark-to-market treatment in current earnings, and result in greater potential for earnings volatility than in the past. This accounting treatment is discussed further in Note 2 “Summary of Significant Accounting Policies” in the “Notes to the Consolidated Financial Statements.”

Geographic Data

See Note 17 “Operating Segments” in the “Notes to the Consolidated Financial Statements.”

Customers

See Note 11 “Major Customers and Concentration of Credit Risk” in the “Notes to the Consolidated Financial Statements.”

Competition

Competition among pipelines is based primarily on transportation charges, access to producing areas and demand for the crude oil by end users. We believe that high capital requirements, environmental considerations and the difficulty in acquiring rights-of-way and related permits make it unlikely that competing pipeline systems comparable in size and scope to our pipeline systems will be built in the foreseeable future. However, to the extent there are already third-party owned pipelines with excess capacity in the vicinity of our operations, we will be exposed to significant competition based on the incremental cost of moving an incremental barrel of crude oil.

We face intense competition in our gathering, marketing, terminalling and storage operations. Our competitors include other crude oil pipeline companies, the major integrated oil companies, their marketing affiliates and independent gatherers, brokers and marketers of widely varying sizes, financial resources and experience. Some of these competitors have capital resources many times greater than ours, and control greater supplies of crude oil.

Regulation

Our operations are subject to extensive regulations. We estimate that we are subject to regulatory oversight by over 70 federal, state, provincial and local departments and agencies, many of which are authorized by statute to issue and have issued laws and regulations binding on the oil pipeline industry, related businesses and individual participants. The failure to comply with such rules and regulations can result in substantial penalties. The regulatory burden on our operations increases our cost of doing business and, consequently, affects our profitability. However, except for certain exemptions that apply to smaller companies, we do not believe that we are affected in a significantly different manner by these laws and regulations than are our competitors. Due to the myriad of complex federal, state, provincial and local regulations that may affect us, directly or indirectly, you should not rely on the following discussion of certain laws and regulations as an exhaustive review of all regulatory considerations affecting our operations.

Pipeline and Storage Regulation

Some of our petroleum pipelines and storage tanks in the United States are subject to regulation by the U.S. Department of Transportation (“DOT”) with respect to the design, installation, testing, construction, operation, replacement and management of pipeline and tank facilities. In addition, we must permit access to and copying of records, and must make certain reports available and provide information as required by the Secretary of Transportation. Comparable regulation exists in Canada and in some states in which we conduct intrastate common carrier or private pipeline operations.

Pipeline safety issues are currently receiving significant attention in various political and administrative arenas at both the state and federal levels. For example, recent federal rule changes require pipeline operators to: (1) develop and maintain a written qualification program for individuals performing covered tasks on pipeline facilities, and (2) establish pipeline integrity management programs. In particular, during 2000, the DOT adopted new regulations requiring operators of interstate pipelines to develop and follow an integrity management program that provides for continual assessment of the integrity of all pipeline segments that could affect so-called “high consequence areas,” including high population areas, areas that are sources of drinking water, ecological resource areas that are unusually sensitive to environmental damage from a pipeline release, and commercially navigable waterways. Segments of our pipelines are located in high consequence areas. The DOT rule requires us to evaluate pipeline conditions by means of periodic internal inspection, pressure testing, or other equally effective assessment means, and to correct identified anomalies. If, as a result of our evaluation process, we determine that there is a need to provide further protection to high consequence areas, then we will be required to implement additional spill prevention, mitigation and risk control measures for our pipelines, including enhanced damage prevention programs, corrosion control program improvements, leak detection system enhancements, installation of emergency flow restricting devices, and emergency preparedness improvements. The DOT rule also requires us to evaluate and, as necessary, improve our management and analysis processes for integrating available integrity-related data relating to our pipeline segments and to remediate potential problems found as a result of the required assessment and evaluation process. Based on currently available information, we estimate that the costs to implement this program will average approximately $1.9 million per year in 2003 and 2004. Such amounts incorporate approximately $1.0 million per year associated with the assets acquired in the Shell acquisition. Although we believe that our pipeline operations are in substantial compliance with applicable regulatory requirements, these requirements increase the potential for incurring significant expenses if additional safety requirements are imposed that exceed our current pipeline control system capabilities. We will continue to refine our estimates as data from initial assessments are collected.

The DOT has adopted API 653 as the standard for the inspection, repair, alteration and reconstruction of existing crude oil storage tanks subject to DOT jurisdiction (approximately 61% of our 22.7 million barrels). API 653 requires regularly scheduled inspection and repair of tanks remaining in service. Full compliance is required by 2009. We have commenced our compliance activities and, based on currently available information, we estimate that we will spend approximately $1.0 million per year in 2003 and 2004 in connection with these activities. Such amounts incorporate the costs associated with the assets acquired in the Shell acquisition. We will continue to refine our estimates as data from initial assessments are collected.

States are largely preempted by federal law from regulating pipeline safety but may assume responsibility for enforcing federal intrastate pipeline regulations and inspection of intrastate pipelines. In practice, states vary considerably in their authority and capacity to address pipeline safety. We do not anticipate any significant problems in complying with applicable state laws and regulations in those states in which we operate.

In the wake of the September 11, 2001 terrorist attacks on the United States, the DOT has developed a security guidance document and has issued a security circular that defines critical pipeline facilities and appropriate countermeasures for protecting them, and explains how DOT plans to verify that operators have taken appropriate action to implement satisfactory security procedures and plans. Using the guidelines provided by the DOT, we have specifically identified certain of our facilities as DOT "critical facilities" and therefore potential terrorist targets. In compliance with DOT guidance, we are performing vulnerability analyses on such facilities. Additional security measures and procedures may be adopted or implemented upon completion of these analyses, and any such measures or procedures have the potential for increasing our costs of doing business. Regardless of the steps taken to increase security, however, we cannot assure you that our facilities will not become the subject of a terrorist attack. See "—Operational Hazards and Insurance."

Transportation Regulation

General Interstate Regulation. Our interstate common carrier pipeline operations are subject to rate regulation by the FERC under the Interstate Commerce Act. The Interstate Commerce Act requires that tariff rates for petroleum pipelines, which includes crude oil, as well as refined product and petrochemical pipelines, be just and reasonable and non-discriminatory.

State Regulation. Our intrastate pipeline transportation activities are subject to various state laws and regulations, as well as orders of regulatory bodies.

Canadian Regulation. Our Canadian pipeline assets are subject to regulation by the NEB and by provincial agencies. With respect to a pipeline over which it has jurisdiction, each of these agencies has the power, upon application by a third party, to determine the rates we are allowed to charge for transportation on, and set other terms of access to, such pipeline. In such circumstances, if the relevant regulatory agency determines that the applicable terms and conditions of service are not just and reasonable, the agency can amend the offending provisions of an existing transportation contract.

Energy Policy Act of 1992 and Subsequent Developments. In October 1992, Congress passed the Energy Policy Act of 1992, which among other things, required the FERC to issue rules establishing a simplified and generally applicable ratemaking methodology for petroleum pipelines and to streamline procedures in petroleum pipeline proceedings. The FERC responded to this mandate by issuing several orders, including Order No. 561. Beginning January 1, 1995, Order No. 561 enables petroleum pipelines to change their rates within prescribed ceiling levels that are tied to an inflation index. Rate increases made pursuant to the indexing methodology are subject to protest, but such protests must show that the portion of the rate increase resulting from application of the index is substantially in excess of the pipeline’s increase in costs. If the indexing methodology results in a reduced ceiling level that is lower than a pipeline’s filed rate, Order No. 561 requires the pipeline to reduce its rate to comply with the lower ceiling. A pipeline must, as a general rule, utilize the indexing methodology to change its rates. The FERC, however, retained cost-of-service ratemaking, market-based rates, and settlement as alternatives to the indexing approach, which alternatives may be used in certain specified circumstances. The Energy Policy Act deemed petroleum pipeline rates in effect for the 365-day period ending on the date of enactment of the Energy Policy Act or that were in effect on the 365th day preceding enactment and had not been subject to complaint, protest or investigation during the 365-day period to be just and reasonable under the Interstate Commerce Act. Generally, complaints against such “grandfathered” rates may only be pursued if the complainant can show either that a substantial change in the economic circumstances or the nature of the services has occurred since enactment or that a provision of the tariff is unduly discriminatory or preferential.

In a proceeding involving Lakehead Pipe Line Company, Limited Partnership (Opinion No. 397), the FERC concluded that there should not be a corporate income tax allowance built into a petroleum pipeline’s rates to reflect income attributable to noncorporate partners because noncorporate partners, unlike corporate partners, do not pay a corporate income tax. On January 13, 1999, the FERC issued Opinion No. 435 in a proceeding involving SFPP, L.P., which, among other things, affirmed Opinion No. 397’s determination that there should not be a corporate income tax allowance built into a petroleum pipeline’s rates to reflect income attributable to noncorporate partners. Additionally, on rehearing of Opinion No. 397, the FERC affirmed its position regarding appropriate income tax allowance. Petitions for review of Opinion No. 435 and subsequent FERC opinions in that case are before the D.C. Circuit Court of Appeals, but some issues are being held in abeyance pending FERC action on certain requests. Once the rehearing process is completed, the FERC’s position on the income tax allowance and on other rate issues could be subject to judicial review.

Our Pipelines. The FERC generally has not investigated rates on its own initiative when those rates have not been the subject of a protest or complaint by a shipper. Substantially all of our gross margins on transportation are produced by rates that are either grandfathered or set by agreement of the parties. Rates for OCS crude are set by transportation agreements with shippers that do not expire until 2007 and provide for a minimum tariff with the potential for annual escalation. The FERC has twice approved the agreed OCS rates, although application of the indexing method would have required their reduction. When these OCS agreements expire in 2007, they will be subject to renegotiation or to any of the other methods for establishing rates under Order No. 561. As a result, we believe that the rates now in effect can be sustained, although no assurance can be given that the rates currently charged would ultimately be upheld if challenged.

Trucking Regulation

We operate a fleet of trucks to transport crude oil and oilfield materials as a private, contract and common carrier. We are licensed to perform both intrastate and interstate motor carrier services. As a motor carrier, we are subject to certain safety regulations issued by the Department of Transportation. The trucking regulations cover, among other things, driver operations, maintaining log books, truck manifest preparations, the placement of safety placards on the trucks and trailer vehicles, drug and alcohol testing, safety of operation and equipment, and many other aspects of truck operations. We are also subject to the Occupational Safety and Health Act, as amended (“OSHA”), with respect to our trucking operations.

Our trucking assets in Canada are subject to regulation by provincial agencies in the provinces in which they are operated. These regulatory agencies do not set freight rates, but do establish and administer rules and regulations relating to other matters including equipment and driver licensing, equipment inspection, hazardous materials and safety.

Cross-Border Regulation

As a result of our Canadian acquisitions and cross-border activities, we are subject to regulatory matters including export licenses, tariffs, Canadian and U.S. customs and tax issues and toxic substance certifications. Regulations include the Short Supply Controls of the Export Administration Act, the North American Free Trade Agreement and the Toxic Substances Control Act. Violations of these license, tariff and tax reporting requirements could result in the imposition of significant administrative, civil and criminal penalties. Furthermore, the failure to comply with U.S., Canadian, state and local tax requirements could lead to the imposition of additional taxes, interest and penalties.

Environmental, Health and Safety Regulation

General

Numerous federal, state and local laws and regulations governing the discharge of materials into the environment, or otherwise relating to the protection of the environment, affect our operations and costs. In particular, our activities in connection with storage and transportation of crude oil and other liquid hydrocarbons and our use of facilities for treating, processing or otherwise handling hydrocarbons and wastes are subject to stringent environmental laws and regulations. As with the industry generally, compliance with existing and anticipated laws and regulations increases our overall cost of business, including our capital costs to construct, maintain and upgrade equipment and facilities. Although these regulations affect our capital expenditures and earnings, we believe that they do not affect our competitive position because our competitors that comply with such laws and regulations are similarly affected. Environmental laws and regulations have historically been subject to change, and we are unable to predict the ongoing cost to us of complying with these laws and regulations or the future impact of such laws and regulations on our operations. Violation of environmental laws and regulations and any associated permits can result in the imposition of significant administrative, civil and criminal penalties, injunctions and construction bans or delays. A discharge of petroleum hydrocarbons or hazardous substances into the environment could, to the extent such event is not insured, subject us to substantial expense, including both the cost to comply with applicable laws and regulations and claims made by neighboring landowners and other third parties for personal injury and property damage.

Water

The Oil Pollution Act, as amended (“OPA”), was enacted in 1990 and amends provisions of the Federal Water Pollution Control Act of 1972, as amended (“FWPCA”), and other statutes as they pertain to prevention and response to oil spills. The OPA subjects owners of facilities to strict, joint and potentially unlimited liability for containment and removal costs, natural resource damages, and certain other consequences of an oil spill, where such spill is into navigable waters, along shorelines or in the exclusive economic zone of the U.S. The OPA establishes a liability limit of $350 million for onshore facilities; however, a party cannot take advantage of this liability limit if the spill is caused by gross negligence or willful misconduct or resulted from a violation of a federal safety, construction, or operating regulation. If a party fails to report a spill or cooperate in the cleanup, the liability limits likewise do not apply. In the event of an oil spill into navigable waters, substantial liabilities could be imposed upon us. States in which we operate have also enacted similar laws. Regulations have been or are currently being developed under OPA and state laws that may also impose additional regulatory burdens on our operations. We believe that we are in substantial compliance with applicable OPA requirements.

The FWPCA imposes restrictions and strict controls regarding the discharge of pollutants into navigable waters. Permits must be obtained to discharge pollutants into state and federal waters. The FWPCA imposes substantial potential liability for the costs of removal, remediation and damages. We believe that compliance with existing permits and compliance with foreseeable new permit requirements will not have a material adverse effect on our financial condition or results of operations.

Some states maintain groundwater protection programs that require permits for discharges or operations that may impact groundwater conditions. We believe that we are in substantial compliance with these state requirements.

Air Emissions

Our operations are subject to the Federal Clean Air Act, as amended, and comparable state, local and provincial statutes. We believe that our operations are in substantial compliance with these statutes in all areas in which we operate.

Amendments to the Federal Clean Air Act enacted in 1990 (the “1990 Federal Clean Air Act Amendments”) as well as recent or soon to be adopted changes to state implementation plans for controlling air emissions in regional non-attainment areas require or will require most industrial operations in the U.S. to incur capital expenditures in order to meet air emission control standards developed by the U.S. Environmental Protection Agency (the “EPA”) and state environmental agencies. The 1990 Federal Clean Air Act Amendments also imposed an operating permit requirement for major sources of air emissions (“Title V permits”), which applies to some of our facilities. We will be required to incur certain capital expenditures in the next several years for air pollution control equipment in connection with obtaining or maintaining permits and approvals addressing air emission related issues. Although we can give no assurances, we believe on-going compliance with the 1990 Federal Clean Air Act Amendments will not have a material adverse effect on our financial condition or results of operations.

Solid Waste

We generate wastes, including hazardous wastes, that are subject to the requirements of the federal Resource Conservation and Recovery Act (“RCRA”) and comparable state statutes. The EPA is considering the adoption of stricter disposal standards for non-hazardous wastes, including oil and gas wastes. We are not currently required to comply with a substantial portion of the RCRA requirements because our operations generate minimal quantities of hazardous wastes. However, it is possible that additional wastes, which could include wastes generated by our operations that are currently classified as non-hazardous wastes, 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. Such changes in the regulations could result in additional capital expenditures or operating expenses for us as well as the industry in general.

Hazardous Substances

The Comprehensive Environmental Response, Compensation and Liability Act, as amended (“CERCLA”), also known as “Superfund,” and comparable state laws impose liability, without regard to fault or the legality of the original act, on certain classes of persons that contributed to the release of a “hazardous substance” into the environment. These persons include the owner or operator of the site or sites where the release occurred and companies that disposed of, or arranged for the disposal of, the hazardous substances found at the site. Under CERCLA, such persons may be subject to joint and several liability for the costs of cleaning up the hazardous substances that have been released into the environment, for damages to natural resources, and for the costs of certain health studies. CERCLA also authorizes the EPA and, in some instances, third parties to act in response to threats to the public health or the environment and to seek to recover the costs they incur from the responsible classes of persons. It is not uncommon for neighboring landowners and other third parties to file claims for personal injury and property damage allegedly caused by hazardous substances or other pollutants released into the environment. In the course of our ordinary operations, we may generate waste that falls within CERCLA’s definition of a “hazardous substance.” We may be jointly and severally liable under CERCLA for all or part of the costs required to clean up sites at which such hazardous substances have been disposed of or released into the environment.

We currently own or lease, and have in the past owned or leased, properties where hydrocarbons are being or have been handled. Although we have utilized operating and disposal practices that were standard in the industry at the time, waste hydrocarbons or other wastes may have been disposed of or released on or under the properties owned or leased by us or on or under other locations where these wastes have been taken for disposal. In addition, many of these properties have been operated by third parties whose treatment and disposal or release of hydrocarbons or other wastes was not under our control. These properties and wastes disposed thereon may be subject to CERCLA, RCRA and analogous state laws. Under such laws, we 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 plugging operations to prevent future contamination. We are currently involved in remediation activities at a number of sites, which involve potentially significant expense. See "—Environmental Remediation."

OSHA

We are subject to the requirements of OSHA, and comparable state statutes that regulate the protection of the health and safety of workers. In addition, the OSHA hazard communication standard requires that certain information be maintained about hazardous materials used or produced in operations and that this information be provided to employees, state and local government authorities and citizens. We believe that our operations are in substantial compliance with OSHA requirements, including general industry standards, record keeping requirements and monitoring of occupational exposure to regulated substances.

Endangered Species Act

The federal Endangered Species Act, as amended (“ESA”), restricts activities that may affect endangered species or their habitats. Although certain of our facilities are in areas that may be designated as habitat for endangered species, we believe that we are in substantial compliance with the ESA. However, the discovery of previously unidentified endangered species could cause us to incur additional costs or operation restrictions or bans in the affected area.

Hazardous Materials Transportation Requirements

The DOT regulations affecting pipeline safety require pipeline operators to implement measures designed to reduce the environmental impact of oil discharge from onshore oil pipelines. These regulations require operators to maintain comprehensive spill response plans, including extensive spill response training for pipeline personnel. In addition, DOT regulations contain detailed specifications for pipeline operation and maintenance. We believe our operations are in substantial compliance with such regulations. See “—Regulation—Pipeline and Storage Regulation.”

Environmental Remediation

In connection with our acquisition of Scurlock Permian, we identified a number of areas of potential environmental exposure. Under the terms of our acquisition agreement, Marathon Ashland is fully indemnifying us for areas of environmental exposure which were identified at the time of the acquisition, including any and all liabilities associated with two Superfund sites at which it is alleged Scurlock Permian deposited waste oils as well as any potential liability for hydrocarbon soil and water contamination at a number of Scurlock Permian facilities. For environmental liabilities which were not identified at the time of the acquisition but which occurred prior to the closing, we have agreed to pay the costs relating to matters that are under $25,000. Our liabilities relating to matters discovered prior to May 2003 and that exceed $25,000, is currently limited to an aggregate of $1.0 million, with Marathon Ashland indemnifying us for any excess amounts. Marathon Ashland’s indemnification obligations for identified sites extend indefinitely while its obligations for non-identified sites extend to matters discovered within four years of the date of acquisition (May 12, 1999) of Scurlock Permian.

In connection with our acquisition of Murphy Oil Company Ltd.'s midstream operations in Canada, we identified a limited number of environmental deficiencies during due diligence. Under the terms of our acquisition agreement, Murphy, at its sole cost and expense, agreed to remediate (to the minimum standards required by applicable environmental law) the identified environmental deficiencies. For environmental deficiencies that were not identified at the time of acquisition, but which occurred prior to closing, and were identified to Murphy prior to January 31, 2002, we have agreed to be responsible up to an aggregate amount of $300,000. Thereafter, Murphy Oil Company Ltd., agreed to remain solely responsible for the costs to remediate that exceed $20,000 for each environmental deficiency for a total of not more than ten (10) environmental deficiencies as chosen by us. Except for the environmental deficiencies identified at the time of acquisition, Murphy's maximum liability for environmental deficiencies identified post-acquisition cannot exceed $2.25 million.

In connection with our acquisition of the West Texas Gathering System, we agreed to be responsible for pre-acquisition environmental liabilities up to an aggregate amount of $1.0 million, while Chevron Pipe Line Company agreed to remain solely responsible for liabilities discovered prior to July 2002 that exceed this $1.0 million threshold.

Based on our investigations of the assets acquired from Marathon Ashland, Murphy and Chevron, we have identified several sites that exceed the threshold limitations under the various indemnities. Although we have not yet determined the total cost of remediation of these sites, we believe our indemnification arrangements should prevent such costs from having a material adverse effect on our financial condition, results of operations or cash flows.

In connection with the Shell Acquisition in 2002, Shell purchased an environmental insurance policy covering known and unknown environmental matters under which we are a named beneficiary. The policy has a $100,000 deductible per site and an aggregate coverage limit of $70 million and expires in 2012.

Other assets we have acquired or will acquire in the future may have environmental remediation liabilities for which we are not indemnified. We may experience future releases of crude oil into the environment from our pipeline and storage operations, or discover releases that were previously unidentified. Although we maintain an extensive inspection program designed to prevent and, as applicable, to detect and address such releases promptly, damages and liabilities incurred due to any future environmental releases from our assets may substantially affect our business.

Operational Hazards and Insurance

A pipeline, terminal or other facilities may experience damage as a result of an accident or natural disaster. These hazards can cause personal injury and loss of life, severe damage to and destruction of property and equipment, pollution or environmental damage and suspension of operations. We maintain insurance of various types that we consider adequate to cover our operations and properties. The insurance covers all of our assets in amounts considered reasonable. The insurance policies are subject to deductibles that we consider reasonable and not excessive. Our insurance does not cover every potential risk associated with operating pipelines, terminals and other facilities including the potential loss of significant revenues. Consistent with insurance coverage generally available to the industry, our insurance policies provide limited coverage for losses or liabilities relating to pollution, with broader coverage for sudden and accidental occurrences. The events of September 11, 2001, and their overall effect on the insurance industry have adversely impacted the availability and cost of coverage. Due to these events, insurers have excluded acts of terrorism and sabotage from our insurance policies. On certain of our key assets, we have purchased a separate insurance policy for acts of terrorism and sabotage.

Since the terrorist attacks, the United States Government has issued numerous warnings that energy assets (including our nation’s pipeline infrastructure) may be future targets of terrorist organizations. These developments expose our operations and assets to increased risks. The DOT has developed a security guidance document and has issued a security circular that defines critical pipeline facilities and appropriate countermeasures for protecting them, and explains how DOT plans to verify that operators have taken appropriate action to implement satisfactory security procedures and plans. Using the guidelines provided by the DOT, we have specifically identified certain of our facilities as DOT “critical facilities” and therefore potential terrorist targets. In compliance with DOT guidance, we are performing vulnerability analyses on such facilities. Upon completion of such analyses, we will institute as appropriate any indicated security measures or procedures that are not already in place. We cannot assure you that these or any other security measures would protect our facilities from a concentrated attack. Any future terrorist attacks on our facilities, those of our customers and, in some cases, those of our competitors, could have a material adverse effect on our business, whether insured or not.

The occurrence of a significant event not fully insured or indemnified against, or the failure of a party to meet its indemnification obligations, could materially and adversely affect our operations and financial condition. We believe that we are adequately insured for public liability and property damage to others with respect to our operations. With respect to all of our coverage, no assurance can be given that we will be able to maintain adequate insurance in the future at rates we consider reasonable.

Title to Properties and Rights-of-Way

We believe that we have satisfactory title to all of our assets. Although title to such properties are subject to encumbrances in certain cases, such as customary interests generally retained in connection with acquisition of real property, liens related to environmental liabilities associated with historical operations, liens for current taxes and other burdens and minor easements, restrictions and other encumbrances to which the underlying properties were subject at the time of acquisition by our predecessor or us, we believe that none of these burdens will materially detract from the value of such properties or from our interest therein or will materially interfere with their use in the operation of our business.

Substantially all of our pipelines are constructed on rights-of-way granted by the apparent record owners of such property and, in some instances, such rights-of-way are revocable at the election of the grantor. 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. In some cases, not all of the apparent record owners have joined in the right-of-way grants, but in substantially all such cases, signatures of the owners of majority interests have been obtained. We have obtained permits from public authorities to cross over or under, or to lay facilities in or along water courses, county roads, municipal streets and state highways, and in some instances, such permits are revocable at the election of the grantor. We have 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. All of the pump stations are located on property owned in fee or property under long-term leases. In certain states and under certain circumstances, we have the right of eminent domain to acquire rights-of-way and lands necessary for our common carrier pipelines.

Some of the leases, easements, rights-of-way, permits and licenses transferred to us, upon our formation in 1998 and in connection with acquisitions we have made since that time, required the consent of the grantor to transfer such rights, which in certain instances is a governmental entity. We believe that we have obtained such third party consents, permits and authorizations as are sufficient for the transfer to us of the assets necessary for us to operate our business in all material respects as described in this report. With respect to any consents, permits or authorizations that have not yet been obtained, we believe that such consents, permits or authorizations will be obtained within a reasonable period, or that the failure to obtain such consents, permits or authorizations will have no material adverse effect on the operation of our business.

Employees

To carry out our operations, our general partner or its affiliates employed approximately 1,200 employees at December 31, 2002. None of the employees of our general partner were represented by labor unions, and our general partner considers its employee relations to be good.

Summary of Tax Considerations

The tax consequences of ownership of common units depends in part on the owner's individual tax circumstances. However, the following is a brief summary of material tax consequences of owning and disposing of common units.

Partnership Status; Cash Distributions

We are classified for federal income tax purposes as a partnership based upon our meeting certain requirements imposed by the Internal Revenue Code (the "Code"), which we must meet each year. The owners of common units are considered partners in the Partnership so long as they do not loan their common units to others to cover short sales or otherwise dispose of those units. Accordingly, we pay no federal income taxes, and a common unitholder is required to report on the unitholder's federal income tax return the unitholder's share of our income, gains, losses and deductions. In general, cash distributions to a common unitholder are taxable only if, and to the extent that, they exceed the tax basis in the common units held.

Partnership Allocations

In general, our income and loss is allocated to the general partner and the unitholders for each taxable year in accordance with their respective percentage interests in the Partnership (including, with respect to the general partner, its incentive distribution right), as determined annually and prorated on a monthly basis and subsequently apportioned among the general partner and the unitholders of record as of the opening of the first business day of the month to which they relate, even though unitholders may dispose of their units during the month in question. A unitholder is required to take into account, in determining federal income tax liability, the unitholder's share of income generated by us for each taxable year of the Partnership ending within or with the unitholder's taxable year, even if cash distributions are not made to the unitholder. As a consequence, a unitholder's share of our taxable income (and possibly the income tax payable by the unitholder with respect to such income) may exceed the cash actually distributed to the unitholder by us. At any time distributions are made on the common units in excess of distributions on the subordinated units, or incentive distributions are made to the general partner, gross income will be allocated to the recipient to the extent of those distributions.

Basis of Common Units

A unitholder's initial tax basis for a common unit is generally the amount paid for the common unit. A unitholder's basis is generally increased by the unitholder's share of our income and decreased, but not below zero, by the unitholder's share of our losses and distributions.

Limitations on Deductibility of Partnership Losses

In the case of taxpayers subject to the passive loss rules (generally, individuals and closely held corporations), any partnership losses are only available to offset future income generated by us and cannot be used to offset income from other activities, including passive activities or investments. Any losses unused by virtue of the passive loss rules may be fully deducted if the unitholder disposes of all of the unitholder's common units in a taxable transaction with an unrelated party.

Section 754 Election

We have made the election provided for by Section 754 of the Code, which will generally result in a unitholder being allocated income and deductions calculated by reference to the portion of the unitholder's purchase price attributable to each asset of the Partnership.

Disposition of Common Units

A unitholder who sells common units will recognize gain or loss equal to the difference between the amount realized and the adjusted tax basis of those common units. A unitholder may not be able to trace basis to particular common units for this purpose. Thus, distributions of cash from us to a unitholder in excess of the income allocated to the unitholder will, in effect, become taxable income if the unitholder sells the common units at a price greater than the unitholder’s adjusted tax basis even if the price is less than the unitholder’s original cost. Moreover, a portion of the amount realized (whether or not representing gain) will be ordinary income.

Foreign, State, Local and Other Tax Considerations

In addition to federal income taxes, unitholders will likely be subject to other taxes, such as foreign, state and local income taxes, unincorporated business taxes, and estate, inheritance or intangible taxes that are imposed by the various jurisdictions in which a unitholder resides or in which we do business or own property. We own property and conduct business in five provinces in Canada as well as in most states in the United States. All but four of those states and all of the provinces currently impose a personal income tax that would generally require a unitholder to file a return and pay taxes in that state or province, as well as in Canada. Of the states in which we primarily do business, only Texas does not have a personal income tax. In certain states, tax losses may not produce a tax benefit in the year incurred (if, for example, we have no income from sources within that state) and also may not be available to offset income in subsequent taxable years. Some states may require us, or we may elect, to withhold a percentage of income from amounts to be distributed to a unitholder. Withholding, the amount of which may be more or less than a particular unitholder's income tax liability owed to the state, may not relieve the nonresident unitholder from the obligation to file an income tax return. Amounts withheld may be treated as if distributed to unitholders for purposes of determining the amounts distributed by us.

It is the responsibility of each prospective unitholder to investigate the legal and tax consequences, under the laws of Canada and those states and localities, of the unitholder's investment in us. Further, it is the responsibility of each unitholder to file all U.S. federal, Canadian, state, provincial and local tax returns that may be required of the unitholder.

Ownership of Common Units by Tax-Exempt Organizations and Certain Other Investors

An investment in common units by tax-exempt organizations (including IRAs and other retirement plans), regulated investment companies (mutual funds) and foreign persons raises issues unique to such persons. Virtually all of our income allocated to a unitholder that is a tax-exempt organization is unrelated business taxable income and, thus, is taxable to such a unitholder. Furthermore, no significant amount of our gross income is qualifying income for purposes of determining whether a unitholder will qualify as a regulated investment company, and a unitholder who is a nonresident alien, foreign corporation or other foreign person is regarded as being engaged in a trade or business in the United States as a result of ownership of a common unit and, thus, is required to file federal income tax returns and to pay tax on the unitholder's share of our taxable income. Finally, distributions to foreign unitholders are subject to federal income tax withholding.

Tax Shelter Registration

The Code generally requires that "tax shelters" be registered with the Secretary of the Treasury. We are registered as a tax shelter with the Secretary of the Treasury. Our tax shelter registration number is 99061000009. Issuance of the registration number does not indicate that an investment in the Partnership or the claimed tax benefits have been reviewed, examined or approved by the Internal Revenue Service.

Unauthorized Trading Loss

Background

In November 1999, we discovered that a former employee had engaged in unauthorized trading activity, resulting in losses of approximately $174.0 million, which includes associated costs and legal expenses. A full investigation into the unauthorized trading activities by outside legal counsel and independent accountants and consultants determined that the vast majority of the losses occurred from March through November 1999, and the impact warranted a restatement of previously reported financial information for 1999 and 1998. Approximately $7.1 million of the unauthorized trading losses was recognized in 1998 and the remainder in 1999. In 2000, we recognized an additional $7.0 million charge for settlement of litigation related to the unauthorized trading losses.

Normally, as we purchase crude oil, we establish a margin by selling crude oil for physical delivery to third parties, or by entering into future delivery obligations with respect to futures contracts. The employee in question violated our policy of maintaining a substantially balanced position between purchases and sales (or future delivery obligations) by negotiating one side of a transaction without negotiating the other, leaving the position “open.” The trader concealed his activities by hiding open trading positions, by rolling open positions forward using off-market, inter-month transactions, and by providing to counter-parties forged documents that purported to authorize such transactions. An “inter-month” transaction is one in which the receipt and delivery of crude oil are scheduled in different months. An “off-market” transaction is one in which the price is higher or lower than the prices available in the market on the day of the transaction. By matching one side of an inter-month transaction with an open position, and using off-market pricing to match the pricing of the open position, the trader could present documentation showing both a purchase and a sale, creating the impression of compliance with our policy. The offsetting side of the inter-month transaction became a new, hidden open position.

Investigation; Enhancement of Procedures

Upon discovery of the violation and related losses, we engaged an outside law firm to lead the investigation of the unauthorized trading activities. The law firm retained specialists from an independent accounting firm to assist in the investigation. In parallel effort with the investigation mentioned above, the role of the accounting firm specialists was expanded to include reviewing and making recommendations for enhancement of our systems, policies and procedures. As a result, we have developed and adopted a written policy document and manual of procedures designed to enhance our processes and procedures and improve our ability to detect any activity that might occur at an early stage. See “—Gathering, Marketing, Terminalling and Storage Operations—Crude Oil Volatility; Counter-Cyclical Balance; Risk Management.”

To specifically address the methods used by the trader to conceal the unauthorized trading, in January 2000, we sent a notice to each of our material counter-parties that no person at Plains All American Pipeline, L.P. was authorized to enter into off-market transactions. In addition, we have taken the following actions:

- We have communicated our hedging and trading strategies and risk tolerance to our traders by more clearly and specifically defining approved strategies and risk limits in our written procedures.

- Our procedures include (i) more comprehensive and frequent reporting that will allow our officers to evaluate risk positions in greater detail, and (ii) enhanced procedures to check compliance with these reporting requirements and to confirm that trading activity was conducted within guidelines.

- The procedures provide a system to educate each employee who is involved, directly or indirectly, in our crude oil transaction activities with respect to policies and procedures, and impose an obligation to notify the Risk Manager directly of any questionable transactions or failure of others to adhere to the policies, practices and procedures.

- Finally, following notification to each of our material counter-parties that off-market trading is against our policy and that any written evidence to the contrary is unauthorized and false, the Risk Manager and our other representatives have communicated our policies and enhanced procedures to our counter- parties to advise them of the information we will routinely require from them to assure timely recording and confirmation of trades.

We can give no assurance that the above steps will serve to detect and prevent all violations of our trading policy; however, we believe that such steps substantially reduce the possibility of a recurrence of unauthorized trading activities, and that any unauthorized trading that does occur would be detected before any material loss could develop.

Effects of the Loss

The unauthorized trading and associated losses resulted in a default of certain covenants under our then-existing credit facilities and significant short-term cash and letter of credit requirements.

In December 1999, we executed amended credit facilities and obtained default waivers from all of our lenders. We paid approximately $13.7 million to our lenders in connection with the amended credit facilities. In connection with the amendments, our former general partner loaned us approximately $114.0 million.

On May 8, 2000, we entered into new credit agreements to refinance our existing debt and repay the $114.0 million owed to our former general partner. The new credit agreements also provided us with additional flexibility for working capital, capital expenditures and other general corporate purposes. At closing, we had $256.0 million outstanding under a senior secured revolving credit facility. We also had at closing letters of credit of approximately $173.8 million and borrowings of approximately $20.3 million outstanding under a separate senior secured letter of credit and borrowing facility. We have since refinanced the credit facilities we entered into on May 8, 2000. See Item 7. “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Credit Facilities and Long-term Debt.”

In the period immediately following the disclosure of the unauthorized trading losses, a significant number of our suppliers and trading partners reduced or eliminated the open credit previously extended to us. Consequently, the amount of letters of credit we needed to support the level of our crude oil purchases then in effect increased significantly. In addition, the cost of letters of credit increased under our credit facility. Some of our purchase contracts were terminated. We believe that by the year 2001, the effects of the loss on our cost of credit and operations were minimal and the requirement for us to issue letters of credit was reduced to levels lower than existed before the unauthorized trading loss.

After the public announcement of the trading losses, class action lawsuits were filed against us and Plains Resources. Derivative lawsuits were also filed. All of the cases have been settled and paid.

Available Information

We make available free of charge on our website (www.paalp.com) our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after we electronically file the material with, or furnish it to, the SEC.

Item 3. *Legal Proceedings*

Export License Matter. In our gathering and marketing activities, we import and export crude oil from and to Canada. Exports of crude oil are subject to the short supply controls of the Export Administration Regulations (“EAR”) and must be licensed by the Bureau of Industry and Security (the “BIS”) of the U.S. Department of Commerce. We have determined that we may have exceeded the quantity of crude oil exports authorized by previous licenses. Export of crude oil in excess of the authorized amounts is a violation of the EAR. On October 18, 2002, we submitted to the BIS an initial notification of voluntary disclosure. The BIS subsequently informed us that we could continue to export while previous exports were under review. We applied for and have received a new license allowing for exports of volumes more than adequately reflecting our anticipated needs. At this time, we have received no indication whether the BIS intends to charge us with a violation of the EAR or, if so, what penalties would be assessed. As a result, we cannot estimate the ultimate impact of these potential violations.

Other. We, in the ordinary course of business, are a claimant and/or a defendant in various other legal proceedings. We do not believe that the outcome of these other legal proceedings, individually and in the aggregate, will have a materially adverse effect on our financial condition, results of operations or cash flows.

Item 4. ***Submission of Matters to a Vote of Security Holders***

No matters were submitted to a vote of the security holders, through solicitation of proxies or otherwise, during the fiscal year covered by this report.