

MAGELLAN MIDSTREAM PARTNERS LP

Form 424B3

February 17, 2005

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Filed Pursuant To Rule 424(b)(3)

Registration No. 333-109732

PROSPECTUS SUPPLEMENT

(To Prospectus dated November 3, 2003)

### 225,144 Common Units

#### Representing Limited Partner Interests

Magellan Midstream Holdings, L.P., the selling unitholder, is offering 225,144 common units representing limited partner interests in Magellan Midstream Partners, L.P. to a purchaser in a privately negotiated transaction pursuant to this prospectus supplement at a price of \$55.52 per common unit. We will not receive any proceeds from the sale of the common units by the selling unitholder in this offering.

*Investing in our common units involves risk. Please read Risk Factors beginning on page S-4 of this prospectus supplement and on page 2 of the accompanying prospectus.*

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**The Securities and Exchange Commission and state securities regulators have not approved or disapproved these securities or determined if this prospectus supplement or the accompanying prospectus is truthful or complete. Any representation to the contrary is a criminal offense.**

February 15, 2005

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This document is in two parts. The first part is this prospectus supplement, which describes the terms of this common unit offering. The second part is the accompanying prospectus, which gives more general information, some of which may not apply to this common unit offering.

If the information about the offering varies between this prospectus supplement and the accompanying prospectus, you should rely on the information in this prospectus supplement.

You should rely only on the information contained or incorporated by reference in this prospectus supplement or the accompanying prospectus. We have not authorized anyone to provide you with different information. This prospectus supplement is not an offer to sell or solicitation of an offer to buy these securities in any state where the offer is not permitted. You should not assume that the information contained in this prospectus supplement or the accompanying prospectus is accurate as of any date other than the dates shown in these documents or that any information we have incorporated by reference is accurate as of any date other than the date of the document incorporated by reference. Our business, financial condition, results of operations and prospects may have changed since such dates.

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**Prospectus dated November 3, 2003**

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**SUMMARY**

*This summary highlights information contained elsewhere in this prospectus supplement and the accompanying prospectus. It does not contain all of the information you should consider before making an investment decision. You should read the entire prospectus supplement, the accompanying prospectus, the documents incorporated by reference and the other documents to which we refer for a more complete understanding of this offering. Please read **Risk Factors** beginning on page S-4 of this prospectus supplement and page 2 of the accompanying prospectus for more information about important factors that you should consider before buying common units in this offering. As used in this prospectus supplement and the accompanying prospectus, unless we indicate otherwise, the terms **our**, **we**, **us** and similar terms refer to Magellan Midstream Partners, L.P., together with our subsidiaries.*

**Magellan Midstream Partners, L.P.**

We are a publicly traded Delaware limited partnership that owns and operates a diversified portfolio of complementary energy assets. We are principally engaged in the transportation, storage and distribution of refined petroleum products.

On October 1, 2004, we acquired more than 2,000 miles of refined petroleum products pipeline system assets from Shell Pipeline Company LP and Equilon Enterprises LLC, which had operated these assets under the name Shell Oil Products US, or Shell, for approximately \$489.7 million. In addition to the assets that we recently acquired from Shell, our other assets consist of:

a 6,700-mile petroleum products pipeline system, including 39 petroleum products terminals, serving the mid-continent region of the United States, referred to as our 6,700-mile petroleum products pipeline system ;

five petroleum products terminal facilities located along the U.S. Gulf Coast and near the New York harbor, referred to as marine terminal facilities ;

29 petroleum products terminals located principally in the southeastern United States, referred to as inland terminals ; and

an 1,100-mile ammonia pipeline system, including six ammonia terminals, serving the mid-continent region of the United States.

Our 6,700-mile petroleum products pipeline system is a common carrier pipeline that provides transportation, storage and distribution services for petroleum products and liquefied petroleum gases, or LPGs, in 11 states from Oklahoma through the Midwest to North Dakota, Minnesota, Wisconsin and Illinois. This system generates revenues principally from tariffs regulated by the Federal Energy Regulatory Commission, or the FERC, based on the volumes transported and also from storage and other ancillary fees. Through direct refinery connections and interconnections with other pipelines, this system can access approximately 41% of the refinery capacity in the United States and is well-positioned to adapt to shifts in product supply or demand.

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Our inland terminals and marine terminal facilities, which we refer to collectively as our petroleum products terminals, store and distribute gasoline and other petroleum products throughout 11 states. Our inland terminals are part of a distribution network located primarily throughout the southeastern United States and used by retail suppliers, wholesalers and marketers to receive gasoline and other petroleum products from large, interstate pipelines and to transfer these products to trucks, railcars or barges for delivery to their final destination. Our marine terminal facilities are large storage terminals that principally serve refiners, marketers and large end-users of petroleum products and are strategically located near major refining hubs along the U.S. Gulf Coast and near the New York harbor. Our petroleum products terminals generate revenues principally from volume-based fees charged for the storage and delivery of gasoline and other petroleum products handled by these terminals.

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Our ammonia pipeline system transports and distributes ammonia from production facilities in Texas and Oklahoma to various distribution points in the Midwest for use as an agricultural fertilizer. Our ammonia pipeline system generates revenues principally from volume-based fees charged for the transportation of ammonia on the pipeline system.

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**THE OFFERING**

|   |   |
|---|---|
| <b>Common units offered by the selling unitholder</b> | 225,144 common units.   |
| <b>Units outstanding after this offering</b>          | 30,340,464 common units and 2,839,848 subordinated units.   |
| <b>Use of proceeds</b>                                | We will not receive any proceeds from this offering.  |
| <b>Risk factors</b>                                   | Please read <b>Risk Factors</b> beginning on page S-4 of this prospectus supplement and on page 2 of the accompanying prospectus for a discussion of risks relating to an investment in our common units. |

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**RISK FACTORS**

*An investment in our common units involves risk. You should carefully read the risk factors set forth below, the risk factors included under the caption Risk Factors beginning on page 2 of the accompanying prospectus, and those risks discussed in our Annual Report on Form 10-K for the year ended December 31, 2003, which is incorporated by reference into this prospectus supplement and the accompanying prospectus.*

***The sale or exchange of 50% or more of our capital and profit interests will result in the termination of our partnership for federal income tax purposes.***

Since February 2004, the selling unitholder has sold common units that represented an approximate 19% interest in our capital and profits for tax purposes, which includes the common units sold in this offering. We will be considered to have been terminated for federal income tax purposes if the common units sold by the selling unitholder, together with all common units sold within a 12-month period, represent a sale or exchange of 50% or more of our capital and profits interests. Our termination for tax purposes would, among other things, result in a significant deferral of the depreciation deductions allowable in computing our taxable income for the year in which the termination occurs. For a discussion of the consequences of our termination for federal income tax purposes, please read Material Tax Consequences Disposition of Common Units Constructive Termination in the accompanying prospectus.

***Our general partner and its affiliates may have conflicts with our partnership.***

The directors and officers of our general partner and its affiliates have duties to manage our general partner in a manner that is beneficial to the selling unitholder, its sole member. At the same time, our general partner has duties to manage us in a manner that is beneficial to us. Therefore, our general partner's duties to us may conflict with the duties of its officers and directors to the selling unitholder.

Such conflicts may include, among others, the following:

decisions of our general partner regarding the amount and timing of cash expenditures, borrowings and issuances of additional limited partnership units or other securities can affect the amount of incentive distribution payments we make to our general partner;

under our partnership agreement, we reimburse our general partner for the costs of managing and operating us; and

under our partnership agreement, it is not a breach of our general partner's fiduciary duties for affiliates of our general partner to engage in activities that compete with us. Specifically, the selling unitholder, which owns our general partner, is partially owned by an affiliate of the Carlyle/Riverstone Global Energy and Power Fund II, L.P., or the Carlyle/Riverstone Fund, which also owns, through affiliates, an interest in the general partner of Buckeye Partners, L.P. and the general partner of SemGroup, L.P. and may acquire other entities that compete with us. SemGroup is currently a significant customer of our petroleum products pipeline system. Although we do not have extensive operations in the geographic areas primarily served by Buckeye Partners, we will compete directly with Buckeye Partners, SemGroup and perhaps other entities in which the Carlyle/Riverstone Fund has an interest for acquisition opportunities throughout the United States and potentially will compete with Buckeye Partners, SemGroup and these



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other entities for new business or extensions of the existing services provided by our operating partnerships, creating actual and potential conflicts of interest between us and affiliates of our general partner.

***The assets acquired from Shell are subject to ongoing remediation obligations, and we may incur substantial environmental costs and liabilities that are not covered by Shell's indemnification of us.***

Some of the assets acquired from Shell have been used for many years to distribute, store or transport petroleum products, and releases may have occurred from terminals or along pipeline rights-of-way that require remediation. In addition, past releases may have occurred but have not yet been discovered, which could require costly future remediation. As part of the acquisition, Shell agreed to retain liabilities and expenses related to active environmental

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remediation projects, other than those relating to the consent decree discussed in the paragraph below. In addition, Shell agreed to indemnify us for certain environmental liabilities arising from pre-closing conditions so long as we provide notice of those conditions no later than October 1, 2006. Shell's indemnification obligation is subject to a \$250,000 per-claim deductible and a \$30.0 million aggregate cap.

In 2003, Shell entered into a consent decree with the United States Environmental Protection Agency arising out of a June 1999 incident unrelated to the assets we acquired from Shell. In order to resolve Shell's civil liability for the incident, Shell agreed to pay civil penalties of \$10.0 million and to comply with certain terms set out in the consent decree. These terms include requirements for testing and maintenance of a number of Shell's pipelines, including two of the pipelines we acquired, the creation of a damage prevention program, submission to independent monitoring and various reporting requirements. The consent decree imposes penalties for non-compliance for a period of at least five years from the date of the consent decree. Under our purchase agreement with Shell, we agreed, at our own expense, to complete any remaining remediation work required under the consent decree with respect to these two pipelines and have assumed a liability of approximately \$8.6 million for this remediation work. Shell has agreed to retain responsibility under the consent decree for any ongoing independent monitoring obligations with respect to one of these pipelines.

If a significant accident or event occurred in the past for which indemnification is not available or if the costs of performing any remediation significantly exceed our expectations, it could adversely affect our financial position, results of operations and our ability to make distributions to our unitholders.

***Rate regulation or a successful challenge to the rates we charge on our petroleum products pipelines may reduce the amount of cash we generate.***

The FERC regulates the tariff rates for interstate movements on our petroleum products pipelines. Shippers may protest our pipeline tariff filings, and the FERC may investigate new or changed tariff rates and order refunds of amounts collected under rates that were in excess of a just and reasonable level. In addition, shippers may challenge the lawfulness of tariff rates that have become final and effective. The FERC may also investigate such rates absent shipper complaint.

The FERC's ratemaking methodologies may limit our ability to set rates based on our true costs or may delay the use of rates that reflect increased costs. The FERC's primary ratemaking methodology is price indexing. We use this methodology to establish our rates in approximately one-third of our interstate markets. The indexing method allows a pipeline to increase its rates by a percentage equal to the change in the producer price index for finished goods, or PPI-FG. If the PPI-FG falls, we could be required to reduce our rates that are based on the FERC's price indexing methodology if they exceed the new maximum allowable rate. In addition, changes in the PPI-FG might not be large enough to fully reflect actual increases in the costs associated with the pipelines subject to indexing.

The potential for a challenge to our indexed rates creates the risk that the FERC might find some of our indexed rates to be in excess of a just and reasonable level—that is, a level justified by our cost of service. In such an event, the FERC would order us to reduce any such rates and could require the payment of reparations to complaining shippers for up to two years prior to the complaint.

On July 20, 2004, the United States Court of Appeals for the District of Columbia Circuit issued its opinion in *BP West Coast Products, LLC v. FERC*, which vacated the FERC's application of its Lakehead policy. Under that policy, the FERC has allowed a regulated entity organized as a master limited partnership to include in its cost of service an income tax allowance to the extent that its unitholders, or limited partners, were corporations subject to income tax. Because the court's ruling on the FERC's Lakehead policy in *BP West Coast* appears to focus on the facts and record presented to it in that case, it is not clear what impact, if any, the opinion will have on our indexed rates. On December 2, 2004, the FERC

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issued a Notice of Inquiry that seeks comments regarding whether BP West Coast applies only to the specific facts of that case, or whether it applies more broadly, and, if the latter, what effect that ruling might have on energy infrastructure investments. It is not clear what action the FERC will ultimately take in response to BP West Coast, to what extent such action will be challenged and, if so, whether it will withstand further FERC or judicial review. Nevertheless, a shipper might rely on this decision to challenge our indexed rates and claim that our income tax allowance should be eliminated. If the FERC were to disallow our income tax allowance, it may be more difficult to justify our indexed rates on a cost of service basis. However, because of the relatively small percentage of our unitholders that are corporations, which results in our including only a small

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income tax allowance in our cost of service, we do not believe that a challenge to our indexed rates based solely on an elimination of our income tax allowance would be likely to succeed.

We establish rates in approximately two-thirds of our markets using the FERC's market-based ratemaking regulations. These regulations allow us to establish rates based on conditions in individual markets without regard to the index or our cost of service. If successfully challenged, the FERC could take away our ability to establish market-based rates. We would then have to establish rates that would be justified on some other basis such as our cost of service.

Any reduction in the indexed rates, removal of our ability to establish market-based rates, or payment of reparations could have a material adverse effect on our operations and reduce the amount of cash we generate.

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**USE OF PROCEEDS**

We will not receive any proceeds from the sale of our common units by the selling unitholder in this offering.

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**Table of Contents****PRICE RANGE OF COMMON UNITS AND DISTRIBUTIONS**

As of February 15, 2005, there were 30,340,464 common units outstanding, held by approximately 36,000 holders, including common units held in street name and units held by Magellan Midstream Holdings, L.P. Our common units are traded on the New York Stock Exchange under the symbol MMP.

As of February 15, 2005, 2,839,848 subordinated units were outstanding. These subordinated units are held by the selling unitholder and are not publicly traded.

The following table sets forth, for the periods indicated, the high and low closing sales prices for our common units, as reported on the New York Stock Exchange Composite Transaction Tape, and quarterly declared cash distributions per common unit. The closing sales price of our common units on the New York Stock Exchange on February 15, 2005 was \$61.23 per common unit.

|   | Price Ranges |          | Cash<br>Distributions<br>Per Unit(a) |
|---|--------------|----------|--------------------------------------|
|   | High         | Low      |                                      |
| <b>2005</b>                               |              |          |                                      |
| First Quarter (through February 15, 2005) | \$ 62.95     | \$ 58.56 | N/A(b)                               |
| <b>2004</b>                               |              |          |                                      |
| Fourth Quarter                            | \$ 59.34     | \$ 53.01 | \$ 0.9125                            |
| Third Quarter                             | 55.00        | 49.77    | 0.8900                               |
| Second Quarter                            | 55.50        | 46.89    | 0.8700                               |
| First Quarter                             | 55.35        | 50.05    | 0.8500                               |
| <b>2003</b>                               |              |          |                                      |
| Fourth Quarter                            | \$ 55.03     | \$ 45.80 | \$ 0.8300                            |
| Third Quarter                             | 48.55        | 42.40    | 0.8100                               |
| Second Quarter                            | 48.20        | 37.54    | 0.7800                               |
| First Quarter                             | 37.19        | 33.30    | 0.7500                               |
| <b>2002</b>                               |              |          |                                      |
| Fourth Quarter                            | \$ 34.70     | \$ 29.50 | \$ 0.7250                            |
| Third Quarter                             | 36.40        | 25.20    | 0.7000                               |
| Second Quarter                            | 42.35        | 30.75    | 0.6750                               |
| First Quarter                             | 43.30        | 32.85    | 0.6125                               |
| <b>2001</b>                               |              |          |                                      |
| Fourth Quarter                            | \$ 44.00     | \$ 37.00 | \$ 0.5900                            |
| Third Quarter                             | 40.40        | 29.40    | 0.5775                               |
| Second Quarter                            | 33.42        | 28.45    | 0.5625                               |
| First Quarter                             | 31.00        | 24.00    | 0.2920                               |

- (a) Cash distributions declared for each respective quarter. Cash distributions were declared and paid within 45 days following the close of each quarter. The cash distribution for the first quarter of 2001 was prorated for the period from February 10, 2001 through March 31, 2001.

- (b) We expect to declare and pay a cash distribution within 45 days following the end of the quarter.

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**Table of Contents****SELLING UNITHOLDER**

The following table sets forth information concerning the ownership of our common units by the selling unitholder. As of February 15, 2005, there were 30,340,464 of our common units outstanding. The percentages indicated below represent the selling unitholder's ownership of our common units.

| <b>Name and Address of Selling Unitholder</b>                                      | <b>Common Units owned immediately prior to this offering</b> |                | <b>Common Units to be offered</b> | <b>Common Units owned immediately after this offering</b> |                |
|--|--|----------------|-----------------------------------|---|----------------|
|  | <b>Common Units</b>  | <b>Percent</b> |                                   | <b>Common Units</b>                                       | <b>Percent</b> |
| Magellan Midstream Holdings, L.P.<br>P. O. Box 22186<br>Tulsa, Oklahoma 74121-2186 | 1,419,923  | 4.7%           | 225,144                           | 1,194,779   | 3.9%           |

The selling unitholder also owns 2,839,848 of our subordinated units which, together with the 1,194,779 common units and 2% general partner interest held by the selling unitholder, represent a 13.9% ownership interest after giving effect to this offering. The number of subordinated units owned by the selling unitholder will not be affected by this offering. For more information about our relationship with the selling unitholder, please see our Form 10-K for the year ended December 31, 2003, which was filed with the SEC on March 10, 2004 and which is incorporated by reference.



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**TAX CONSIDERATIONS**

The tax consequences to you of an investment in our common units will depend in part on your own tax circumstances. For a discussion of the principal federal income tax considerations associated with our operations and the purchase, ownership and disposition of our common units, please read **Material Tax Consequences** in the accompanying prospectus. You are urged to consult with your own tax advisor about the federal, state and local tax consequences that are specific to your circumstances.

We estimate that if you purchase common units in this offering and own them through the record date for the distribution for the fourth quarter of 2007, then you will be allocated, on a cumulative basis, an amount of federal taxable income for that period that will be less than 20% of the cash distributed with respect to that period. These estimates are based upon the assumption that our available cash for distribution will approximate the amount required to distribute cash to the holders of our common units in an amount of at least the current quarterly distribution of \$0.9125 per unit and other assumptions with respect to capital expenditures, cash flow and anticipated cash distributions. These estimates and assumptions are subject to, among other things, numerous business, economic, regulatory, competitive and political uncertainties beyond our control. Further, the estimates are based on current tax law and certain tax reporting positions that we have adopted with which the Internal Revenue Service could disagree. Accordingly, we cannot assure you that the estimates will be correct. The actual percentage of distributions that will constitute taxable income could be higher or lower, and any differences could be material and could materially affect the value of the common units. Please read **Material Tax Consequences** in the accompanying prospectus.

Ownership of common units by tax-exempt entities, regulated investment companies and foreign investors raises issues unique to such persons. Recent legislation treats net income derived from the ownership of certain publicly traded partnerships (including us) as qualifying income to a regulated investment company. However, this legislation is only effective for taxable years beginning after October 22, 2004, the date of enactment. For taxable years beginning prior to the date of enactment, very little of our income will be qualifying income to a regulated investment company. Please read **Material Tax Consequences Tax-Exempt Organizations and Other Investors** in the accompanying prospectus.

Because of widespread state budget deficits, several states are evaluating ways to subject partnerships to entity-level taxation through the implementation of state income, franchise or other forms of taxation. If any state were to impose a tax upon us as an entity, our cash available for distribution would be reduced.

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**PLAN OF DISTRIBUTION**

The selling unitholder is selling the common units offered under this prospectus supplement directly to an investor in a privately negotiated transaction in which no party is acting as an underwriter. Subject to the terms of a purchase agreement dated January 10, 2005, the investor has agreed to purchase and the selling unitholder has agreed to sell to the investor 225,144 common units at a price of \$55.52 per common unit. The selling unitholder determined the price per common unit through negotiations with the investor based upon the market price for the common units.

The selling unitholder expects to deliver the common units through The Depository Trust Company against payment of the aggregate purchase price for the common units purchased on February 16, 2005.

**EXPERTS**

The consolidated balance sheets of Magellan Midstream Partners, L.P. (formerly Williams Energy Partners L.P.) as of December 31, 2002 and 2003 and the related consolidated statements of income, cash flows and partners' capital for each of the years ended December 31, 2001, 2002 and 2003 appearing in Magellan Midstream Partners, L.P.'s (formerly Williams Energy Partners L.P.) Annual Report on Form 10-K for the year ended December 31, 2003 and the consolidated balance sheets of Magellan GP, LLC (formerly WEG GP LLC) as of December 31, 2002 and 2003 appearing in Magellan Midstream Partners, L.P.'s Annual Report on Form 10-K for the year ended December 31, 2003 have been audited by Ernst & Young LLP, independent registered public accounting firm, as set forth in their reports thereon, included therein and incorporated herein by reference. Such consolidated balance sheets and financial statements are incorporated herein by reference in reliance upon such report given on the authority of such firm as experts in accounting and auditing.

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**INFORMATION REGARDING FORWARD-LOOKING STATEMENTS**

This prospectus supplement and the documents incorporated in this prospectus supplement by reference include forward-looking statements. These forward-looking statements are identified as any statement that does not relate strictly to historical or current facts. They use words such as anticipate, believe, intend, plan, projection, forecast, strategy, position, continue, estimate, expect, may, will, or other variations of them or comparable terminology. In particular, statements, express or implied, concerning future actions, conditions or events or future operating results or the ability to generate sales, income, cash flow or cash to be distributed to unitholders are forward-looking statements. Forward-looking statements are not guarantees of performance. They involve risks, uncertainties and assumptions. Future actions, conditions or events and future results of operations may differ materially from those expressed in these forward-looking statements. Many of the factors that will determine these results are beyond the ability of us and our affiliates to control or predict. In addition to the risk factors included under Risk Factors in this prospectus supplement and the accompanying prospectus, other specific factors which could cause actual results to differ from those in the forward-looking statements include:

price trends and overall demand for natural gas liquids, refined petroleum products, natural gas, oil and ammonia in the United States;

weather patterns materially different from historical trends;

development of alternative energy sources;

changes in demand for storage in our petroleum products terminals;

changes in supply patterns for our marine terminals due to geopolitical events;

our ability to manage interest rate and commodity price exposure;

changes in our tariff rates implemented by the FERC, the United States Surface Transportation Board and/or state regulators;

shut-downs or cutbacks at major refineries, petrochemical plants, ammonia production facilities or other businesses that use or supply our services;

changes in throughput on petroleum products pipelines owned and operated by third parties and connected to our petroleum products terminals or petroleum products pipeline system;

loss of one or more of our three customers on our ammonia pipeline system;

an increase in the competition our operations encounter;

the occurrence of an operational hazard or unforeseen interruption for which we are not adequately insured;

our ability to integrate any acquired operations into our existing operations;

our ability to successfully identify and close strategic acquisitions and expansion projects and make cost saving changes in operations;

changes in general economic conditions in the United States;

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

the cost and effects of legal and administrative claims and proceedings against us or our subsidiaries;

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

the condition of the capital markets and equity markets in the United States;

the effect of changes in accounting policies;

the potential that our internal controls may not be adequate, weaknesses may be discovered in these controls or remediation of any identified weaknesses may not be successful, and the impact that could have on our unit price;

our ability to manage rapid growth;

Magellan Midstream Holdings, L.P.'s ability to perform on its environmental indemnification and general and administrative reimbursement obligations to us;

The Williams Companies, Inc.'s ability to pay the amounts owed to us under its indemnification settlement with us;

the ability of our general partner to enter into certain agreements which could negatively impact our financial position, results of operations and cash flows;

supply disruption; and

global and domestic economic repercussions from terrorist activities and international hostilities and the government's response thereto.

You should not put undue reliance on any forward-looking statements.

When considering forward-looking statements, please review the risk factors described under "Risk Factors" in this prospectus supplement, the accompanying prospectus and those risks discussed in our Annual Report on Form 10-K for the year ended December 31, 2003.

**WHERE YOU CAN FIND MORE INFORMATION**

The SEC allows us to incorporate by reference information we file with it. This procedure means that we can disclose important information to you by referring you to documents we filed with the SEC. The information we incorporate by reference is part of this prospectus supplement and later information that we file with the SEC (excluding any information furnished pursuant to Item 2.02 or Item 7.01 on any Current Report on Form 8-K) will automatically update and supersede this information. We incorporate by reference the documents listed below:

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Annual Report on Form 10-K for the year ended December 31, 2003;

Quarterly Reports on Form 10-Q for the quarters ended March 31, 2004, June 30, 2004 and September 30, 2004;

Definitive Proxy Statement on Schedule 14A filed on March 10, 2004;

Current Reports on Form 8-K filed on May 5, 2004, May 18, 2004, May 21, 2004, May 25, 2004, May 27, 2004, June 24, 2004, August 13, 2004, September 16, 2004, October 1, 2004, October 7, 2004, October 15, 2004, October 26, 2004, December 15, 2004 and February 2, 2005 (as amended on February 3, 2005); and

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the description of our common units contained in our Form 8-A initially filed February 2, 2001, and any subsequent amendment thereto filed for the purpose of updating such description.

You may request a copy of these filings at no cost by making written or telephone requests for copies to:

Magellan Midstream Partners, L.P.

P.O. Box 22186

Tulsa, Oklahoma 74121-2186

Attention: Investor Relations Department

Telephone: (918) 574-7000

We also make available free of charge on our internet website at <http://www.magellanlp.com> our annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, and any amendments to those reports, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. Information contained on our website is not part of this prospectus supplement or the accompanying prospectus.

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**PROSPECTUS**

**14,590,312 Common Units**

**7,830,924 Class B Common Units**

**5,679,694 Subordinated Units**

**MAGELLAN MIDSTREAM PARTNERS, L.P.**

**Representing Limited Partner Interests**

This prospectus relates to:

14,590,312 common units representing limited partner interests in Magellan Midstream Partners, L.P., which include 13,510,618 common units representing limited partner interests in Magellan Midstream Partners, L.P. that may be issued upon conversion of 7,830,924 Class B common units and 5,679,694 subordinated units registered herein;

7,830,924 Class B common units representing limited partner interests in Magellan Midstream Partners, L.P.; and

5,679,694 subordinated units representing limited partner interests in Magellan Midstream Partners, L.P.

The common units, the Class B common units and the subordinated units (collectively, the Units ) may be offered from time to time by the selling unitholder named in this prospectus or in any supplement to this prospectus. We will not receive any proceeds from the sale of Units by the selling unitholder.

Our common units are traded on the New York Stock Exchange under the symbol MMP. On October 13, 2003, the last reported sales price of our common units was \$48.11 per common unit. Prior to this offering, there has not been a public market for the Class B common units or the subordinated units. We will provide information in the prospectus supplement for the expected trading market, if any, for the Class B common units and the subordinated units.



Limited partnerships are inherently different from corporations. You should carefully consider each of the factors described under **Risk Factors**, which begin on page 2 of this prospectus before you make an investment in our securities.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of the securities or passed upon the accuracy or adequacy of this prospectus. Any representation to the contrary is a criminal offense.

The date of this prospectus is November 3, 2003

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You should rely only on the information contained or incorporated by reference in this prospectus or any prospectus supplement. We have not authorized any other person to provide you with different information. You should not assume that the information incorporated by reference or provided in this prospectus or any prospectus supplement is accurate as of any date other than the date on the front of each document.

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**ABOUT THIS PROSPECTUS**

This prospectus is part of a registration statement that we filed with the Securities and Exchange Commission (the SEC) using a shelf registration process. Under this shelf process, the selling unitholder may sell up to:

14,590,312 common units representing limited partner interests in Magellan Midstream Partners, L.P., which include 13,510,618 common units representing limited partner interests in Magellan Midstream Partners, L.P. that may be issued upon conversion of 7,830,924 Class B common units and 5,679,694 subordinated units registered herein;

7,830,924 Class B common units representing limited partner interests in Magellan Midstream Partners, L.P.; and

5,679,694 subordinated units representing limited partner interests in Magellan Midstream Partners, L.P.

Each time the selling unitholder offers securities, we will provide you with a prospectus supplement that will describe, among other things, the specific amounts and prices of the securities being offered and the terms of the offering. The prospectus supplement may also add, update or change information contained in this prospectus. Therefore, before you invest in our securities, you should read this prospectus and any prospectus supplement and any additional information described under the heading **Where You Can Find More Information**.

As used in this prospectus, we, us, our and Magellan Midstream Partners mean Magellan Midstream Partners, L.P. and, where the context requires, include our operating subsidiaries.

**ABOUT MAGELLAN MIDSTREAM PARTNERS**

We were formed by The Williams Companies, Inc. (or The Williams Companies) in August 2000 to own, operate and acquire a diversified portfolio of complementary energy assets. We are principally engaged in the transportation, storage and distribution of refined petroleum products and ammonia.

On June 17, 2003, Magellan Midstream Holdings, L.P. formerly WEG Acquisitions, L.P., a new entity recently formed by Madison Dearborn Partners, LLC and Carlyle/Riverstone Global Energy and Power Fund II, L.P., purchased from The Williams Companies all of the membership interests in our general partner and all of the Class B common units, common units and subordinated units held by The Williams Companies and its affiliates. Effective September 1, 2003, we changed our name to Magellan Midstream Partners, L.P.

Our principal executive offices are located in One Williams Center, P. O. Box 22186, Tulsa, Oklahoma 74121-2186 and our phone number is (877) 934-6571.



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**RISK FACTORS**

*Limited partner interests are inherently different from capital stock of a corporation, although many of the business risks to which we are subject are similar to those that would be faced by a corporation engaged in a similar business. You should carefully consider the following risk factors together with all of the other information included in this prospectus, any prospectus supplement and the documents we have incorporated by reference into this document in evaluating an investment in the common units.*

*If any of the following risks were actually to occur, our business, financial condition or results of operations could be materially adversely affected. In that case, the trading price of our common units could decline and you could lose all or part of your investment.*

**Risks Related to Our Business**

***We may not be able to generate sufficient cash from operations to allow us to pay the minimum quarterly distribution following establishment of cash reserves and payment of fees and expenses, including payments to our general partner.***

The amount of cash we can distribute on our common units principally depends upon the cash we generate from our operations. Because the cash we generate from operations will fluctuate from quarter to quarter, we may not be able to pay the minimum quarterly distribution for each quarter. Our ability to pay the minimum quarterly distribution each quarter depends primarily on cash flow, including cash flow from financial reserves and working capital borrowings, and not solely on profitability, which is affected by non-cash items. As a result, we may make cash distributions during periods when we record losses and may not make cash distributions during periods when we record net income.

***Potential future acquisitions and expansions, if any, may affect our business by substantially increasing the level of our indebtedness and contingent liabilities and increasing our risk of being unable to effectively integrate these new operations.***

From time to time, we evaluate and acquire assets and businesses that we believe complement our existing assets and businesses. Acquisitions may require substantial capital or the incurrence of substantial indebtedness. If we consummate any future acquisitions, our capitalization and results of operations may change significantly, and you will not have the opportunity to evaluate the economic, financial and other relevant information that we will consider in determining the application of these funds and other resources.

Acquisitions and business expansions involve numerous risks, including difficulties in the assimilation of the assets and operations of the acquired businesses, inefficiencies and difficulties that arise because of unfamiliarity with new assets and the businesses associated with them and new geographic areas and the diversion of management's attention from other business concerns. Further, unexpected costs and challenges may arise whenever businesses with different operations or management are combined, and we may experience unanticipated delays in realizing the benefits of an acquisition. Following an acquisition, we may discover previously unknown liabilities associated with the acquired business for which we have no recourse under applicable indemnification provisions.

*Our financial results depend on the demand for the refined petroleum products that we transport, store and distribute.*

Any sustained decrease in demand for refined petroleum products in the markets served by our pipeline and terminals could result in a significant reduction in the volume of products that we transport in our pipeline, store at our marine terminal facilities and distribute through our inland terminals, and therefore reduce our cash flow and our ability to pay cash distributions to you. Factors that could lead to a decrease in market demand include:

an increase in the market price of crude oil that leads to higher refined product prices, which may reduce demand for gasoline and other petroleum products. Market prices for refined petroleum products are subject to wide fluctuation in response to changes in global and regional supply over which we have no control;



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a recession or other adverse economic condition that results in lower spending by consumers and businesses on transportation fuels such as gasoline, jet fuel and diesel;

higher fuel taxes or other governmental or regulatory actions that increase the cost of gasoline;

an increase in fuel economy, whether as a result of a shift by consumers to more fuel-efficient vehicles or technological advances by manufacturers; and

the increased use of alternative fuel sources, such as fuel cells and solar, electric and battery-powered engines. Several state and federal initiatives mandate this increased use.

***When prices for the future delivery of petroleum products that we transport through our pipeline system or store in our marine terminals fall below current prices, customers are less likely to store these products, thereby reducing our storage revenues.***

This market condition is commonly referred to as backwardation. When the petroleum product market is in backwardation, the demand for storage capacity at our facilities may decrease. If the market becomes strongly backwardated for an extended period of time, it may affect our ability to pay cash distributions.

***We depend on petroleum product pipelines owned and operated by others to supply our terminals.***

Most of our inland and marine terminal facilities that are not connected to the Magellan Pipeline, formerly known as the Williams Pipe Line, depend on connections with petroleum product pipelines owned and operated by third parties. Reduced throughput on these pipelines because of testing, line repair, damage to pipelines, reduced operating pressures or other causes could result in our being unable to deliver products to our customers from our terminals or receive products for storage and could adversely affect our ability to meet our financial obligations and pay cash distributions.

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

On September 11, 2001, the United States was the target of terrorist attacks of unprecedented scale. Since the September 11 attacks, the U.S. government has issued warnings that energy assets, specifically our nation's pipeline infrastructure, may be future targets of terrorist organizations. These developments have subjected our operations to increased risks. Any future terrorist attack on our facilities, those of our customers and, in some cases, those of other pipelines, could have a material adverse effect on our business.

***Our business involves many hazards and operational risks, some of which may not be covered by insurance.***

Our operations are subject to many hazards inherent in the transportation of refined petroleum products and ammonia, including ruptures, leaks and fires. These risks could result in substantial losses due to personal injury or loss of life, severe damage to and destruction of property and

equipment and pollution or other environmental damage and may result in curtailment or suspension of our related operations. We are not fully insured against all risks incident to our business. In addition, as a result of market conditions, premiums for our insurance policies have increased substantially and could escalate further. In some instances, insurance could become unavailable or available only for reduced amounts of coverage. For example, insurance carriers are now requiring broad exclusions for losses due to war risk and terrorist and sabotage acts. If a significant accident or event occurs that is not fully insured, it could adversely affect our financial position or results of operations.

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***Rate regulation or a successful challenge to the rates we charge on the Magellan Pipeline system may reduce the amount of cash we generate.***

The Federal Energy Regulatory Commission, or the FERC, regulates the tariff rates for the Magellan Pipeline system. Shippers may protest the pipeline system's tariffs, and the FERC may investigate the lawfulness of new or changed tariff rates and order refunds of amounts collected under rates ultimately found to be unlawful. The FERC may also investigate tariff rates that have become final and effective.

The FERC's ratemaking methodologies may limit our ability to set rates based on our true costs or may delay the use of rates that reflect increased costs. The FERC's primary ratemaking methodology is price indexing. We use this methodology to establish our rates in approximately one-third of our interstate markets. The indexing method allows a pipeline to increase its rates by a percentage equal to the change in the producer price index, or PPI. If the PPI falls, we could be required to reduce our rates that are based on the FERC's price indexing methodology if they exceed the new maximum allowable rate. In addition, changes in the PPI might not be large enough to fully reflect actual increases in the costs associated with the pipeline.

In recent decisions involving unrelated pipeline limited partnerships, the FERC has ruled that these partnerships may not claim an income tax allowance for income attributable to non-corporate limited partners. A shipper could rely on these decisions to challenge our indexed rates and claim that, because we now own the Magellan Pipeline system, the Magellan Pipeline system's income tax allowance should be reduced. If the FERC were to disallow all or part of our income tax allowance, it may be more difficult to justify our rates. If a challenge were brought and the FERC found that some of the indexed rates exceed levels justified by the cost of service, the FERC would order a reduction in the indexed rates and could require reparations for a period of up to two years prior to the filing of a complaint.

We establish rates in approximately two-thirds of our markets using the FERC's market-based ratemaking regulations. These regulations allow us to establish rates based on conditions in individual markets without regard to the index or our cost of service. If successfully challenged, the FERC could take away our ability to establish market-based rates. Any reduction in the indexed rates, removal of our ability to establish market-based rates, or payment of reparations could have a material adverse effect on our operations and reduce the amount of cash we generate.

***Mergers among our customers and competitors could result in lower volumes being shipped on our pipeline and/or products stored in our terminals, thereby reducing the amount of cash we generate.***

Mergers between existing customers could provide strong economic incentives for the combined entities to utilize their existing systems instead of ours in those markets where the systems compete. As a result, we could lose some or all of the volumes and associated revenues from these customers and we could experience difficulty in replacing those lost volumes and revenues. Because most of our operating costs are fixed, a reduction in volumes would result in not only a reduction of revenues, but also a decline in net income and cash flow of a similar magnitude, which would reduce our ability to meet our financial obligations and pay cash distributions.

***The closure of mid-continent refineries that supply the Magellan Pipeline system could result in disruptions or reductions in the volumes transported on the Magellan Pipeline system and reduce the amount of cash we generate.***

The U.S. Environmental Protection Agency recently adopted requirements that require refineries to install equipment to lower the sulfur content of gasoline and some diesel fuel they produce. The requirements relating to gasoline will take effect and be implemented beginning in 2004, and

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the requirements relating to diesel fuel will take effect in 2006 and be implemented through 2010. If refinery owners that use the Magellan Pipeline system determine that compliance with these new requirements is too costly, they may close some of these refineries, which could reduce the volumes transported on the Magellan Pipeline system and the amount of cash we generate.

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*Our business is subject to federal, state and local laws and regulations that govern the environmental and operational safety aspects of our operations.*

Each of our operating segments is subject to the risk of incurring substantial costs and liabilities under environmental and safety laws. These costs and liabilities arise under increasingly strict environmental and safety laws, including regulations and governmental enforcement policies, and as a result of claims for damages to property or persons arising from our operations. Failure to comply with these laws and regulations may result in assessment of administrative, civil and criminal penalties, imposition of cleanup and site restoration costs and liens and, to a lesser extent, issuance of injunctions to limit or cease operations. If we were unable to recover these costs through increased revenues, our ability to meet our financial obligations and pay cash distributions could be adversely affected.

The terminal and pipeline facilities that comprise the Magellan Pipeline system have been used for many years to transport, distribute or store petroleum products. Over time, operations by us, our predecessors or third parties may have resulted in the disposal or release of hydrocarbons or solid wastes at or from these terminal properties and along such pipeline rights-of-way. In addition, our pipeline and some of our terminals are located on or near current or former refining and terminal sites, and there is a risk that contamination is present on those sites. We may be held jointly and severally liable under a number of these environmental laws and regulations for such disposal and releases of hydrocarbons or solid wastes or the existence of contamination, even in circumstances where such activities or conditions were caused by third parties not under our control or were otherwise lawful at the time that they occurred.

In addition, we own a number of properties that have been used for many years to distribute or store petroleum products by third parties not under our control. In some cases, owners, tenants or users of these properties have disposed of or released hydrocarbons or solid wastes on or under these properties. In addition, some of our terminals are located on or near current or former refining and terminal operations, and there is a risk that contamination is present on these sites. The transportation of ammonia by our pipeline is hazardous and may result in environmental damage, including accidental releases that may cause death or injuries to humans and farm animals and damage to crops.

*Competition with respect to our operating segments could ultimately lead to lower levels of profits and reduce the amount of cash we generate.*

We face competition from other pipelines and terminals in the same markets as the Magellan Pipeline system, as well as from other means of transporting, storing and distributing petroleum products. In addition, our marine and inland terminals face competition from large, generally well-financed companies that own many terminals, as well as from small companies. Our marine and inland terminals also encounter competition from integrated refining and marketing companies that own their own terminal facilities. Our customers demand delivery of products on tight time schedules and in a number of geographic markets. If our quality of service declines or we cannot meet the demands of our customers, they may use our competitors. We compete primarily with rail carriers for the transportation of ammonia. If our customers elect to transport ammonia by rail rather than pipeline, we may realize lower revenues and cash flows and our ability to pay cash distributions may be adversely affected. Our ammonia pipeline also competes with another ammonia pipeline in Iowa and Nebraska.

*Our ammonia pipeline system is dependent on three customers.*

Three customers ship all of the ammonia on our pipeline and utilize the six terminals that we own and operate on the pipeline. We have contracts with Koch Nitrogen Company, Agrium U.S. Inc. and Terra Nitrogen, L.P. through June 2005 that obligate them to ship-or-pay for specified minimum quantities of ammonia. One of these customers has a credit rating below investment grade. The loss of any one of these three customers or their failure or inability to pay us could adversely affect our ability to pay cash distributions to you.



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*The Williams Companies has sold its interest in our general partner. As a result of the sale, Magellan Midstream Holdings entered into a new omnibus agreement with The Williams Companies and certain of its affiliates to provide general and administrative services to us for a fixed charge, which will result in higher general and administrative expenses and reduce the amount of cash we generate.*

In connection with the sale to Magellan Midstream Holdings by The Williams Companies of 100% of its ownership interests in our general partner and all of its limited partner interests in us, we are a third-party beneficiary of a new omnibus agreement with Magellan Midstream Holdings. There are limitations through 2010 on the amount of general and administrative expenses for which we are required to reimburse Magellan Midstream Holdings and certain of its affiliates, which will operate as follows:

for expenses below a lower cap amount, we are required to reimburse Magellan Midstream Holdings and these affiliates;

for expenses above the lower cap amount and below an upper cap amount, we are not required to reimburse Magellan Midstream Holdings or these affiliates; and

for expenses above the upper cap amount, we are required to reimburse Magellan Midstream Holdings and these affiliates, although The Williams Companies will reimburse Magellan Midstream Holdings for these amounts through June 2004.

The initial lower cap amount for 2003 is equivalent to the 2003 cap under the old omnibus agreement of approximately \$37.9 million, but will escalate annually beginning in 2004 at 7% (or, if greater, the percentage increase in the Consumer Price Index), which is a higher escalation rate than under the old omnibus agreement. The upper cap amount is \$49.3 million for 2003, but will escalate annually beginning in 2004 at the lesser of 2.5% or the percentage increase in the Consumer Price Index.

These limitations on our obligation to reimburse Magellan Midstream Holdings and certain of its affiliates for general and administrative expenses will terminate upon a change of control of Magellan Midstream Holdings or our general partner. A change of control of our general partner will be deemed to occur if, among other things, directors are elected whose nomination for election to our general partner's board of directors was not approved by our general partner or its board of directors or any nominating committee thereof at a time when the board was comprised of only such approved directors or the current directors. The amount of cash we generate will be reduced by any general and administrative costs we incur (1) above the lower cap amount in the event of a change of control of Magellan Midstream Holdings or our general partner or (2) above the upper cap amount.

*The sale of The Williams Companies' interests in our general partner requires us to separate from The Williams Companies, which in turn, will require us to obtain certain services from other sources, which could increase our costs and limit our ability to pay cash distributions.*

We have entered into a new services agreement with Magellan Midstream Holdings and our general partner. The services provided under the new services agreement include accounting, building administration, human resources, information technology, legal and security, among others. As with our old services agreement, Magellan Midstream Holdings will have the right at any time to terminate its obligations under this services agreement upon 90 days notice. To the extent that neither Magellan Midstream Holdings nor any of its subsidiaries, including our general partner, provides these services to us, the limitations under the new omnibus agreement on our reimbursement of general and administrative expenses relating to these services would no longer apply and we may incur increased general and administrative expenses, which could increase our costs and limit our ability to pay cash distributions.





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### ***Indemnities provided by The Williams Companies related to assets contributed at our initial public offering and our acquisition of the Magellan Pipeline system create credit exposure to The Williams Companies.***

The Williams Companies and certain of its affiliates have indemnified us for certain liabilities and expenses related to the (1) assets they contributed to us at the time of our initial public offering, (2) their contribution of Magellan Pipeline to us in April 2002 and (3) the sale of 100% of their interest in our general partner and all of their limited partner interest in us to Magellan Midstream Holdings. These indemnities primarily address environmental liabilities related to matters that arose prior to our ownership of these assets. The Williams Companies has experienced financial and liquidity difficulties that have resulted in the loss of its investment grade credit rating. If The Williams Companies were unable to indemnify us for these liabilities, it would increase our environmental costs and reduce the amount of cash we generate.

### ***Our secured indebtedness could limit our ability to raise cash to fund future obligations or liquidity concerns.***

As of September 30, 2003, our total outstanding long-term indebtedness was approximately \$570.0 million, including \$480.0 million of senior secured notes and approximately \$90.0 million under our credit facility. The indebtedness represented by our senior secured notes and under our credit facility is secured by substantially all of our assets.

Covenants in our debt instruments restrict the aggregate amount of debt that we can borrow. In addition, these covenants restrict our ability to incur additional indebtedness or liens, sell assets, make loans or investments, and acquire or be acquired by other companies. These debt instruments also provide that, if a change in control of Magellan Midstream Holdings or our general partner occurs, this indebtedness may become due. In such event, we cannot assure you that we would be able to repay this indebtedness.

## **Risks Related to Our Partnership Structure**

### ***Cost reimbursements due our general partner may be substantial and could reduce our cash available for distribution.***

Prior to making any distribution on the common units, Class B common units or subordinated units, we will reimburse the general partner and its affiliates, including officers and directors of our general partner, for expenses they incur on our behalf. The reimbursement of expenses could adversely affect our ability to pay cash distributions. Our general partner has sole discretion to determine the amount of these expenses, subject to certain annual limits. In addition, our general partner and its affiliates may provide us other services for which we will be charged fees as determined by our general partner.

### ***Unitholders have limited voting rights and control of management.***

Our general partner manages and controls our activities and the activities of our operating partnerships. Although our unitholders elect the board of directors of our general partner, they have no right to elect the general partner on an annual or other ongoing basis. However, if the general partner resigns or is removed, its successor may be elected by holders of a majority of the limited partnership units. Unitholders may remove the general partner only by a vote of the holders of at least 66<sup>2</sup>/<sub>3</sub>% of the common units and the subordinated units. As a result, unitholders will have

limited influence on matters affecting our operations, and third parties may find it difficult to gain control of us or influence our actions.

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

Our partnership agreement requires our general partner to deduct from operating surplus cash reserves that in its reasonable discretion are necessary to fund our future operating expenditures. In addition, the partnership agreement permits our general partner to reduce available cash by establishing cash reserves for the proper conduct of our

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business, to comply with applicable law or agreements to which we are a party or to provide funds for future distributions to partners. These cash reserves will affect the amount of cash available for distribution to our unitholders.

*We may issue additional common units without your approval, which would dilute your existing ownership interests.*

During the subordination period, our general partner may cause us to issue up to 2,839,847 additional common units without your approval. Our general partner may also cause us to issue an unlimited number of additional common units, without your approval, in a number of circumstances, such as:

the issuance of common units in connection with acquisitions that increase cash flow from operations per unit on a pro forma basis;

the conversion of subordinated units into common units;

the conversion of the general partner interest and the incentive distribution rights into common units as a result of the withdrawal of our general partner;

issuances of common units under our long-term incentive plan; or

issuances of common units to repay up to \$40.0 million in indebtedness.

The issuance of additional common units or other equity securities of equal or senior rank will have the following effects:

your proportionate ownership interest in us will decrease;

the amount of cash available for distribution on each unit may decrease;

since a lower percentage of total outstanding units will be subordinated units, the risk that a shortfall in the payment of the minimum quarterly distribution will be borne by the common unitholders will increase;

the relative voting strength of each previously outstanding unit may be diminished; and

the market price of the common units may decline.

After the end of the subordination period, we may issue an unlimited number of limited partner interests of any type without the approval of the unitholders. Our partnership agreement does not give the unitholders the right to approve our issuance of equity securities ranking junior to the common units.

*You may not have limited liability if a court finds that unitholder actions constitute control of our business.*

Under Delaware law, you could be held liable for our obligations to the same extent as a general partner if a court determined that the right of unitholders to remove our general partner or to take other action under the partnership agreement constituted participation in the control of our business.

The general partner generally has unlimited liability for the obligations of the partnership, such as its debts and environmental liabilities, except for those contractual obligations of the partnership that are expressly made without recourse to the general partner. In addition, Section 17-607 of the Delaware Revised Uniform Limited Partnership Act provides that, under some circumstances, a unitholder may be liable to us for the amount of a distribution for a period of three years from the date of the distribution.

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### **Tax Risks to Common Unitholders**

You should read **Material Tax Consequences** for a more complete discussion of the expected federal income tax consequences related to owning and disposing of common units.

*Our tax treatment depends on our status as a partnership for federal income tax purposes, as well as our not being subject to entity-level taxation by states. If the IRS treats us as a corporation or we become subject to entity-level taxation for state tax purposes, it would reduce the amount of cash we could distribute.*

The after-tax economic benefit of an investment in the common units depends largely on our being treated as a partnership for federal income tax purposes. If we were classified as a corporation for federal income tax purposes, we would pay federal income tax on our income at the corporate rate. Some or all of the distributions made to unitholders would be treated as dividend income, and no income, gains, losses or deductions would flow through to unitholders. Treatment of us as a corporation would cause a material reduction in our cash flow, which would reduce our ability to meet our financial obligations and pay cash distributions.

In addition, because of widespread state budget deficits, several states are evaluating ways to subject partnerships to entity-level taxation through the imposition of state income, franchise or other forms of taxation. If any state were to impose a tax upon us as an entity, the cash available to pay distributions would be reduced. The partnership agreement provides that, if a law is enacted or existing law is modified or interpreted in a manner that subjects us to taxation as a corporation or otherwise subjects us to entity-level taxation for federal, state or local income tax purposes, then the minimum quarterly distribution and the target distribution levels will be decreased to reflect that impact on us.

*Recent changes in federal income tax law could affect the value of our common units.*

On May 28, 2003, the Jobs and Growth Tax Relief Reconciliation Act of 2003 was signed into law, which generally reduces the maximum tax rate applicable to corporate dividends to 15%. This reduction could materially affect the value of our common units in relation to alternative investments in corporate stock, as investments in corporate stock may be more attractive to individual investors thereby exerting downward pressure on the market price of our common units.

*A successful IRS contest of the federal income tax positions we take may adversely impact the market for common units, and the costs of any contests will be borne by our unitholders and our general partner.*

The IRS may adopt positions that differ from the conclusions of our counsel expressed in this prospectus or from the positions we take. It may be necessary to resort to administrative or court proceedings to sustain our counsel's conclusions or the positions we take. A court may not concur with our counsel's conclusions or the positions we take. Any contest with the IRS may materially and adversely impact the market for common units and the price at which they trade. In addition, the costs of any contest with the IRS, principally legal, accounting and related fees, will be borne indirectly by our unitholders and our general partner.

*You may be required to pay taxes even if you do not receive any cash distributions.*

You will be required to pay federal income taxes and, in some cases, state and local income taxes on your share of our taxable income even if you do not receive any cash distributions from us. You may not receive cash distributions from us equal to your share of our taxable income or even equal to the actual tax liability that results from your share of our taxable income.

*Tax gain or loss on disposition of common units could be different than expected.*

If you sell your common units, you will recognize gain or loss equal to the difference between the amount realized and your tax basis in those common units. Prior distributions in excess of the total net taxable income you

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were allocated for a common unit, which decreased your tax basis in that common unit, will, in effect, become taxable income to you if the common unit is sold at a price greater than your tax basis in that common unit, even if the price you receive is less than your original cost. A substantial portion of the amount realized, whether or not representing gain, may be ordinary income to you. Should the IRS successfully contest some positions we take, you could recognize more gain on the sale of units than would be the case under those positions, without the benefit of decreased income in prior years. Also, if you sell your units, you may incur a tax liability in excess of the amount of cash you receive from the sale.

***Tax-exempt entities, regulated investment companies and foreign persons face unique tax issues from owning common units that may result in adverse tax consequences to them.***

Investment in common units by tax-exempt entities, such as individual retirement accounts (known as IRAs), regulated investment companies (known as mutual funds) and foreign persons, raises issues unique to them. For example, virtually all of our income allocated to organizations exempt from federal income tax, including individual retirement accounts and other retirement plans, will be unrelated business taxable income and will be taxable to them. Very little of our income will be qualifying income to a regulated investment company or mutual fund. Distributions to foreign persons will be reduced by withholding taxes at the highest effective U.S. federal income tax rate for individuals, and foreign persons will be required to file federal income tax returns and pay tax on their share of our taxable income.

***We are registered as a tax shelter. This may increase the risk of an IRS audit of us or a unitholder.***

We are registered with the IRS as a tax shelter. Our tax shelter registration number is 01036000014. The IRS requires that some types of entities, including some partnerships, register as tax shelters in response to the perception that they claim tax benefits that the IRS may believe to be unwarranted. As a result, we may be audited by the IRS and tax adjustments could be made. Any unitholder owning less than a 1% profits interest in us has very limited rights to participate in the income tax audit process. Further, any adjustments in our tax returns will lead to adjustments in our unitholders' tax returns and may lead to audits of unitholders' tax returns and adjustments of items unrelated to us. You will bear the cost of any expense incurred in connection with an examination of your personal tax return.

***We will treat each purchaser of common units as having the same tax benefits without regard to the units purchased. The IRS may challenge this treatment, which could adversely affect the value of our common units.***

Because we cannot match transferors and transferees of common units, we adopt depreciation and amortization positions that do not conform with all aspects of final Treasury regulations. A successful IRS challenge to those positions could adversely affect the amount of tax benefits available to you. It also could affect the timing of these tax benefits or the amount of gain from your sale of common units and could have a negative impact on the value of the common units or result in audit adjustments to your tax returns. Please read **Material Tax Consequences** **Uniformity of Units** for a further discussion of the effect of the depreciation and amortization positions we adopt.

***You will likely be subject to state and local taxes in states where you do not live as a result of an investment in our common units.***

In addition to federal income taxes, you will likely be subject to other taxes, including state and local income taxes, unincorporated business taxes and estate, inheritance or intangible taxes that are imposed by the various jurisdictions in which we do business or own property, even if you do not reside in any of those jurisdictions. You will likely be required to file state and local income tax returns and pay state and local

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income taxes in many or all of the jurisdictions. Further, you may be subject to penalties for failure to comply with those requirements. It is your responsibility to file all United States federal, state and local tax returns. Our counsel has not rendered an opinion on the state or local tax consequences of an investment in the common units.



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**FORWARD-LOOKING STATEMENTS**

Some of the information included in this prospectus, the accompanying prospectus supplement and the documents we incorporate by reference contains forward-looking statements. These statements use forward-looking words such as may, will, anticipate, believe, expect, project or similar words. These statements discuss goals, intentions and expectations as to future trends, plans, events, results of operations or financial condition or state other forward-looking information. These statements reflect Magellan Midstream Partners' current views with respect to future events and are subject to various risks, uncertainties and assumptions including, but not limited, to the following:

price trends and overall demand for natural gas liquids, refined petroleum products, natural gas, oil and ammonia in the United States;

weather patterns materially different than historical trends;

development of alternative energy sources;

changes in demand for storage in our petroleum products terminals;

changes in our tariff rates implemented by the FERC and the United States Surface Transportation Board;

shut-downs or cutbacks at major refineries, petrochemical plants, ammonia production facilities or other businesses that use or supply our services;

changes in the throughput on petroleum products pipelines owned and operated by third parties and connected to our petroleum products terminals;

loss of one or all of our three customers on our ammonia pipeline system;

changes in the federal government's policy regarding farm subsidies, which negatively impact the demand for ammonia and reduce the amount of ammonia transported through our ammonia pipeline system;

an increase in the competition our operations encounter;

the occurrence of an operational hazard or unforeseen interruption for which we are not adequately insured;

our ability to integrate any acquired operations into our existing operations;

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our ability to successfully identify and close strategic acquisitions and make cost saving changes in operations;

changes in general economic conditions in the United States;

changes in laws and regulations to which we are subject, including tax, environmental and employment laws and regulations;

the cost and effects of legal and administrative claims and proceedings against us or our subsidiaries;

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

the condition of the capital markets and equity markets in the United States;

the ability to raise capital in a cost-effective way;

the effect of changes in accounting policies;

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the ability to manage rapid growth;

supply disruption; and

global and domestic economic repercussions from terrorist activities and the government's response thereto.

A forward-looking statement may include a statement of the assumptions or bases underlying the forward-looking statement. We believe we have chosen these assumptions or bases in good faith and that they are reasonable. However, we caution you that assumed facts or bases almost always vary from actual results, and the differences between assumed facts or bases and actual results can be material, depending on the circumstances. When considering forward-looking statements, you should keep in mind the risk factors and other cautionary statements in this prospectus, any prospectus supplement and the documents we have incorporated by reference. We will not update these statements unless the securities laws require us to do so.

**USE OF PROCEEDS**

The Units representing limited partner interests to be offered and sold using this prospectus will be offered and sold by the selling unitholder named in this prospectus or in any supplement to this prospectus. We will not receive any proceeds from the sale of Units by the selling unitholder.

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**DESCRIPTION OF THE COMMON UNITS**

**General**

The common units represent limited partner interests that entitle the holders to participate in our cash distributions and to exercise the rights and privileges available to limited partners under our partnership agreement. For a description of the relative rights and preferences of holders of common units, holders of subordinated units, holders of Class B common units and our general partner in and to cash distributions, see Cash Distribution Policy in this prospectus.

Our outstanding common units are listed in the New York Stock Exchange, or NYSE, under the symbol MMP.

The transfer agent and registrar for our common units is Bank of New York.

**Status as Limited Partner or Assignee**

Except as described below under Limited Liability, the common units will be fully paid, and unitholders will not be required to make additional capital contributions to us.

**Transfer of Common Units**

Each purchaser of common units offered by this prospectus must execute a transfer application whereby the purchaser requests admission as a substituted limited partner and makes representations and agrees to provisions stated in the transfer application. If this action is not taken, a purchaser will not be registered as a record holder of common units on the books of our transfer agent or issued a common unit certificate. Purchasers may hold common units in nominee accounts.

An assignee, pending its admission as a substituted limited partner, is entitled to an interest in us equivalent to that of a limited partner with respect to the right to share in allocations and distributions, including liquidating distributions. Our general partner will vote and exercise other powers attributable to common units owned by an assignee who has not become a substituted limited partner at the written direction of the assignee. Transferees who do not execute and deliver transfer applications will be treated neither as assignees nor as record holders of common units and will not receive distributions, federal income tax allocations or reports furnished to record holders of common units. The only right the transferees will have is the right to admission as a substituted limited partner in respect of the transferred common units upon execution of a transfer application in respect of the common units. A nominee or broker who has executed a transfer application with respect to common units held in street name or nominee accounts will receive distributions and reports pertaining to its common units.

**Limited Liability**

Assuming that a limited partner does not participate in the control of our business within the meaning of the Delaware Act and that he otherwise acts in conformity with the provisions of our partnership agreement, his liability under the Delaware Act will be limited, subject to some possible exceptions, generally to the amount of capital he is obligated to contribute to us in respect of his common units plus his share of any undistributed profits and assets.

Under the Delaware Act, a limited partnership may not make a distribution to a partner to the extent that at the time of the distribution, after giving effect to the distribution, all liabilities of the limited partnership, other than liabilities to partners on account of their partnership interests and liabilities for which the recourse of creditors is limited to specific property of the partnership, exceed the fair value of the assets of the limited partnership.

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### **Reports and Records**

As soon as practicable, but in no event later than 120 days after the close of each fiscal year, our general partner will furnish or make available to each unitholder of record (as of a record date selected by our general partner) an annual report containing our audited financial statements for the past fiscal year. These financial statements will be prepared in accordance with generally accepted accounting principles. In addition, no later than 90 days after the close of each quarter (except the fourth quarter), our general partner will furnish or make available to each unitholder of record (as of a record date selected by our general partner) a report containing our unaudited financial statements and any other information required by law.

Our general partner will use all reasonable efforts to furnish each unitholder of record information reasonably required for tax reporting purposes within 90 days after the close of each fiscal year. Our general partner's ability to furnish this summary tax information will depend on the cooperation of unitholders in supplying information to our general partner. Each unitholder will receive information to assist him in determining his U.S. federal and state and Canadian federal and provincial tax liability and filing his U.S. federal and state and Canadian federal and provincial income tax returns.

A limited partner can, for a purpose reasonably related to the limited partner's interest as a limited partner, upon reasonable demand and at his own expense, have furnished to him:

a current list of the name and last known address of each partner;

a copy of our tax returns;

information as to the amount of cash and a description and statement of the agreed value of any other property or services, contributed or to be contributed by each partner and the date on which each became a partner;

copies of our partnership agreement, our certificate of limited partnership, amendments to either of them and powers of attorney which have been executed under our partnership agreement;

information regarding the status of our business and financial condition; and

any other information regarding our affairs as is just and reasonable.

### **Preemptive Rights**

None of the holders of common units is entitled to preemptive rights in respect of issuances of securities by us. Our general partner has the right, upon our issuance of any class of partnership securities to third parties, to purchase partnership securities of such class from us on the same terms that we issue such class of partnership securities to those third parties to the extent necessary to maintain the percentage interests of our general partner and its affiliates equal to that which existed immediately prior to our issuance of such class of partnership securities. Moreover, upon the issuance of any additional limited partner interests by us, our general partner is required to make additional capital contributions to

maintain its general partner equity interest in us.

**Registration Rights**

Subject to the terms and conditions of our partnership agreement, our general partner and its affiliates have the right to cause us to register for resale under the Securities Act and applicable state securities laws any Units that they hold. We are obligated to pay all expenses incidental to the registration, excluding underwriting discounts and commissions.

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**DESCRIPTION OF THE CLASS B COMMON UNITS**

In connection with our acquisition of Magellan Pipeline Company, formerly Williams Pipe Line Company, our general partner amended our partnership agreement to create a new series of units designated as Class B common units. The Class B common units, together with our common units and subordinated units, represent limited partner interests in us.

**Distributions**

Magellan Midstream Holdings, as the holder of the Class B common units, has the same rights as the holders of our common units with respect to distributions and allocations of income, gain, loss and deductions. However, during the period from April 11, 2002 to November 15, 2002, during which the short-term loan we used to finance the acquisition of Magellan Pipeline Company was outstanding, the holder of the Class B common units did not receive distributions of any kind with respect to the Class B common units. Upon our repayment in full of the short-term loan, The Williams Companies, as the holder of the Class B common units at that time, received a distribution of available cash with respect to its Class B common units of \$1.38 for each Class B common unit, which was equal to the distributions of available cash that were paid or declared payable to the common units during the term of the short-term loan.

If by November 12, 2003 the Class B common units have not converted into common units and remain outstanding, distributions are required to be made as though each Class B common unit were 1.15 common units. The increase in distributions would be effective for the entire quarter in which this step-up period begins, and it would reduce the amount of cash available to be distributed to the common unitholders. The purpose of the step-up in distributions is to compensate the holder of the Class B common units for continuing to hold Class B common units for which there is no public market. The increase in distributions terminates upon the approval of our common unitholders to convert the Class B common units into common units.

**Dissolution and Liquidation**

The Class B common units have the same rights as the common units upon our dissolution and liquidation, including the right to share in any liquidating distributions. Accordingly, the amount of any liquidating distribution on each Class B common unit will equal 100% of the amount of such distribution on each common unit.

**Voting Rights**

The Class B common units have no voting rights, except with respect to amendments to our partnership agreement that would have a material adverse effect on the rights or preferences of the Class B common unit in relation to other classes of partnership interests (including the common units, the subordinated units and the general partnership interest). No Class B common unit is deemed outstanding for the purpose of determining any vote or quorum. However, if our general partner or any of its affiliates (including Magellan Midstream Holdings) pledge any of the Class B common units as collateral to secure indebtedness and such collateral is transferred to the holders of such indebtedness as a result of a default with respect to such indebtedness, each Class B common unit will have voting rights that are identical to the voting rights of the common units and will vote with the common units as a single class on each matter with respect to which the common units are entitled to vote.



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In addition, the Class B common units are not entitled to vote and are not deemed outstanding for purposes of determining a quorum with respect to matters in which the requisite vote is determined by NYSE listing rules. Each Class B common unit is entitled to one vote on each matter with respect to which the Class B common units are entitled to vote.

### **Redemption Rights**

We have the right to redeem the Class B common units for cash by giving 30 day written notice to the holders of the Class B common units. The terms of the Class B common units allow us to redeem the Class B common units for cash based on the 20-day average closing price of the common units prior to the redemption date. We have not elected to redeem the Class B common units.

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### **Preemptive Rights**

Like the holders of the common units, the holders of Class B common units are not entitled to preemptive rights in respect of issuances of securities by us. For a description of our general partner's preemptive rights, see "Description of the Common Units - Preemptive Rights."

## **DESCRIPTION OF THE SUBORDINATED UNITS**

The subordinated units represent a separate class of limited partner interests in us, and the rights of holders of subordinated units to participate in distributions to partners differ from, and are subordinated to, the rights of the holders of common units. For any given quarter, any available cash will first be distributed to the general partner and to the holders of common units and Class B common units, until the holders of common units and Class B common units have received the minimum quarterly distribution plus any arrearages, and then will be distributed to the holders of subordinated units. Please read "Cash Distributions."

### **Conversion of Subordinated Units**

The subordination period will generally extend until the first day of any quarter beginning after December 31, 2005, in which each of the following events occurs:

- (1) distributions of available cash from operating surplus on the common units, Class B common units and the subordinated units equal or exceed the sum of the minimum quarterly distributions on all of the outstanding common units, Class B common units and subordinated units for each of the three non-overlapping four-quarter periods immediately preceding that date;
- (2) the adjusted operating surplus generated during each of the three immediately preceding non-overlapping four-quarter periods equals or exceeds the sum of the minimum quarterly distributions on all of the outstanding common units, Class B common units and subordinated units during those periods on a fully diluted basis and the related distribution on the 2% general partner interest during those periods; and
- (3) there are no arrearages in payment of the minimum quarterly distribution on the common units.

Before the end of the subordination period, 25% of the subordinated units (up to 1,419,923 subordinated units) will convert early into common units on a one-for-one basis on the first day after the record date established for the distribution for any quarter ending on or after December 31, 2003, and 25% of the subordinated units (up to 1,419,923 subordinated units) will convert early into common units on a one-for-one basis on the first day after the record date established for the distribution for any quarter ending on or after December 31, 2004, if at the end of the applicable quarter each of the following three events occurs:

- (1) distributions of available cash from operating surplus on the common units and the subordinated units equal or exceed the sum of the minimum quarterly distributions on all of the outstanding common units and subordinated units for each of the three non-overlapping four-quarter periods immediately preceding that date;

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- (2) the adjusted operating surplus generated during each of the three immediately preceding non-overlapping four-quarter periods equals or exceeds the sum of the minimum quarterly distributions on all of the outstanding common units and subordinated units during those periods on a fully diluted basis and the related distribution on the 2% general partner interest during those periods; and
- (3) there are no arrearages in payment of the minimum quarterly distribution on the common units;

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provided, however, that the early conversion of the second 25% of the subordinated units may not occur until at least one year following the early conversion of the first 25% of the subordinated units.

Upon expiration of the subordination period, all remaining subordinated units will convert into common units on a one-for-one basis and will then participate, pro rata, with the other common units in distributions of available cash. In addition, if Magellan GP, LLC is removed as our general partner under circumstances where cause does not exist and units held by the general partner and its affiliates are not voted in favor of that removal:

the subordination period will end and all outstanding subordinated units will immediately convert into common units on a one-for-one basis;

any existing arrearages in payment of the minimum quarterly distribution on the common units will be extinguished; and

the general partner will have the right to convert its general partner interest and its incentive distribution rights into common units or to receive cash in exchange for those interests.

## **Limited Voting Rights**

Holders of subordinated units sometimes vote as a single class together with the common units and sometimes vote as a class separate from the holders of common units. Holders of subordinated units, like holders of common units and Class B common units, have very limited voting rights. In addition, the subordinated units generally have reduced voting rights equal to one-half vote for each unit owned. During the subordination period, common units (i) vote as a single class and (ii) vote together with subordinated units as a class on the following matters (for the following matters, each common unit shall count as one unit and have one vote and each subordinated unit will count as one-half of a unit and have one-half of a vote):

- (1) a sale or exchange of all or substantially all of our assets;
- (2) the election of a successor general partner in connection with the removal or withdrawal of the general partner;
- (3) dissolution or reconstitution;
- (4) a merger;
- (5) issuance of limited partner interests in some circumstances; and
- (6) some amendments to the partnership agreement, including any amendment that would cause us to be treated as an association taxable as a corporation.

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The subordinated units are not entitled to vote on approval of the withdrawal of the general partner or the transfer by the general partner of its general partner interest or incentive distribution rights under some circumstances. Removal of the general partner requires:

a 66<sup>2</sup>/3% vote of all outstanding units voting as a single class (for this purpose, each common unit shall count as one unit and have one vote and each subordinated unit will count as one-half of a unit and have one-half of a vote); and

the election of a successor general partner by the holders of a majority of the outstanding common units and subordinated units, voting as separate classes.

Under the partnership agreement, the general partner generally will be permitted to effect amendments to the partnership agreement that do not materially adversely affect unitholders without the approval of any unitholders.

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### **Distributions Upon Liquidation**

If we liquidate during the subordination period, in some circumstances holders of outstanding common units and Class B common units will be entitled to receive more liquidating distributions per unit than holders of outstanding subordinated units. The per unit difference will depend upon the amount of gain or loss that we recognize in liquidating our assets. Following conversion of the subordinated units into common units, all units will be treated the same upon liquidation.

## **CASH DISTRIBUTIONS**

### **Distributions of Available Cash**

*General.* Within approximately 45 days after the end of each quarter, we will distribute all of our available cash to unitholders of record on the applicable record date.

*Definition of Available Cash.* Available cash generally means, for each fiscal quarter, all cash on hand at the end of the quarter:

less the amount of cash that the general partner determines in its reasonable discretion is necessary or appropriate to:

provide for the proper conduct of our business;

comply with applicable law, any of our debt instruments, or other agreements; or

provide funds for distributions to our unitholders and to our general partner for any one or more of the next four quarters;

plus all cash on hand on the date of determination of available cash for the quarter resulting from working capital borrowings made after the end of the quarter. Working capital borrowings are generally borrowings that are made under our credit facility and in all cases are used solely for working capital purposes or to pay distributions to partners.

*Intent to Distribute the Minimum Quarterly Distribution.* We intend to distribute to holders of common units, Class B common units and subordinated units on a quarterly basis at least the minimum quarterly distribution of \$0.525 per quarter or \$2.10 per year to the extent we have sufficient cash from our operations after the establishment of cash reserves and the payment of fees and expenses, including payments to our general partner. However, there is no guarantee that we will pay the minimum quarterly distribution on the common units in any quarter, and we will be prohibited from making any distributions to unitholders if it would cause an event of default, or an event of default is existing, under our debt instruments.

### **Operating Surplus, Capital Surplus and Adjusted Operating Surplus**

*General.* All cash distributed to unitholders will be characterized either as operating surplus or capital surplus. We distribute available cash from operating surplus differently than available cash from capital surplus.

*Definition of Operating Surplus.* For any period, operating surplus generally means:

our cash balance on the closing date of our initial public offering; plus

\$15.0 million; plus

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all of our cash receipts since the closing of our initial public offering, excluding cash from borrowings that are not working capital borrowings, sales of equity and debt securities and sales or other dispositions of assets outside the ordinary course of business; plus

working capital borrowings made after the end of a quarter but before the date of determination of operating surplus for the quarter; less

all of our operating expenditures since the closing of our initial public offering, including the repayment of working capital borrowings, but not the repayment of other borrowings, and including maintenance capital expenditures; less

the amount of cash reserves that the general partner deems necessary or advisable to provide funds for future operating expenditures.

*Definition of Capital Surplus.* Capital surplus will generally be generated only by:

borrowings other than working capital borrowings;

sales of debt and equity securities; and

sales or other disposition of assets for cash, other than inventory, accounts receivable and other current assets sold in the ordinary course of business or as part of normal retirements or replacements of assets.

*Characterization of Cash Distributions.* We will treat all available cash distributed as coming from operating surplus until the sum of all available cash distributed since we began operations equals the operating surplus as of the most recent date of determination of available cash. We will treat any amount distributed in excess of operating surplus, regardless of its source, as capital surplus. We do not anticipate that we will make any distributions from capital surplus.

*Definition of Adjusted Operating Surplus.* Adjusted operating surplus is intended to reflect the cash generated from operations during a particular period and therefore excludes net increases in working capital borrowings and net drawdowns of reserves of cash generated in prior periods.

Adjusted operating surplus for any period generally means:

operating surplus generated with respect to that period; less

any net increase in working capital borrowings with respect to that period; less

any net reduction in cash reserves for operating expenditures with respect to that period not relating to an operating expenditure made with respect to that period; plus



any net decrease in working capital borrowings with respect to that period; plus

any net increase in cash reserves for operating expenditures with respect to that period required by any debt instrument for the repayment of principal, interest or premium.

**Subordination Period**

*General.* During the subordination period, the holders of our common units and Class B common units will have the right to receive distributions of available cash from operating surplus in an amount equal to the minimum quarterly distribution of \$0.525 per unit, plus any arrearages in the payment of the minimum quarterly distribution on the common units from prior quarters, before any distributions of available cash from operating surplus may be made on the subordinated units. The purpose of the subordinated units is to increase the likelihood that during the subordination period there will be available cash to be distributed on the common units and Class B common units.

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*Definition of Subordination Period.* The subordination period will extend until the first day of any quarter beginning after December 31, 2005 that each of the following tests are met:

distributions of available cash from operating surplus on all outstanding units equaled or exceeded the minimum quarterly distribution for each of the three consecutive, non-overlapping four-quarter periods immediately preceding that date;

the adjusted operating surplus generated during each of the three immediately preceding non-overlapping four-quarter periods equaled or exceeded the sum of the minimum quarterly distributions on all of the outstanding units during those periods on a fully diluted basis and the related distribution on the 2% general partner interest during those periods; and

there are no arrearages in payment of the minimum quarterly distribution on the common units.

*Early Conversion of Subordinated Units.* Before the end of the subordination period, 50% of the subordinated units, or up to 2,839,847 subordinated units, may convert into common units on a one-for-one basis on the first day after the record date established for the distribution for any quarter ending on or after:

December 31, 2003 with respect to 25% of the subordinated units; and

December 31, 2004 with respect to 25% of the subordinated units.

The early conversions will occur if at the end of the applicable quarter each of the following three tests are met:

distributions of available cash from operating surplus on each of the outstanding common units and subordinated units equaled or exceeded the minimum quarterly distribution for each of the three consecutive, non-overlapping four-quarter periods immediately preceding that date;

the adjusted operating surplus generated during each of the three consecutive, non-overlapping four-quarter periods immediately preceding that date equaled or exceeded the sum of the minimum quarterly distributions on all of the outstanding common units and subordinated units during those periods on a fully diluted basis and the related distribution on the 2% general partner interest during those periods; and

there are no arrearages in payment of the minimum quarterly distribution on the common units.

However, the early conversion of the second 25% of the subordinated units may not occur until at least one year following the early conversion of the first 25% of the subordinated units.

*Effect of Expiration of the Subordination Period.* Upon expiration of the subordination period, each outstanding subordinated unit will convert into one common unit and will then participate pro rata with the other common units in distributions of available cash. In addition, if the unitholders remove our general partner other than for cause and units held by the general partner and its affiliates are not voted in favor of this

removal:

the subordination period will end and each subordinated unit will immediately convert into one common unit;

any existing arrearages in payment of the minimum quarterly distribution on the common units will be extinguished; and

the general partner will have the right to convert its general partner interest and its incentive distribution rights into common units or to receive cash in exchange for those interests.

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### **Distributions of Available Cash From Operating Surplus During the Subordination Period**

We will make distributions of available cash from operating surplus for any quarter during the subordination period in the following manner:

*First*, 98% to common unitholders and Class B common unitholders, pro rata, and 2% to the general partner until we distribute for each outstanding common unit and Class B common unit an amount equal to the minimum quarterly distribution for that quarter;

*Second*, 98% to the common unitholders and Class B common unitholders, pro rata, and 2% to the general partner until we distribute for each outstanding common unit and Class B common unit an amount equal to any arrearages in payment of the minimum quarterly distribution on the common units and Class B common units for any prior quarters during the subordination period;

*Third*, 98% to the subordinated unitholders, pro rata, and 2% to the general partner until we distribute for each subordinated unit an amount equal to the minimum quarterly distribution for that quarter; and

*Thereafter*, in the manner described in [Incentive Distribution Rights](#) below.

### **Distributions of Available Cash From Operating Surplus After the Subordination Period**

We will make distributions of available cash from operating surplus for any quarter after the subordination period in the following manner:

*First*, 98% to all unitholders, pro rata, and 2% to the general partner until we distribute for each outstanding unit an amount equal to the minimum quarterly distribution for that quarter; and

*Thereafter*, in the manner described in [Incentive Distribution Rights](#) below.

### **Incentive Distribution Rights**

Incentive distribution rights represent the right to receive an increasing percentage of quarterly distributions of available cash from operating surplus after the minimum quarterly distribution and the target distribution levels have been achieved. Our general partner currently holds the incentive distribution rights, but may transfer these rights separately from its general partner interest, subject to restrictions in the partnership agreement.

If, for any quarter:

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we have distributed available cash from operating surplus to the common and subordinated unitholders in an amount equal to the minimum quarterly distribution; and

we have distributed available cash from operating surplus on outstanding common units in an amount necessary to eliminate any cumulative arrearages in payment of the minimum quarterly distribution;

then, we will distribute any additional available cash from operating surplus for that quarter among the unitholders and the general partner in the following manner:

*First*, 98% to all unitholders, pro rata, and 2% to the general partner, until each unitholder receives a total of \$0.578 per unit for that quarter (the first target distribution );

*Second*, 85% to all unitholders, pro rata, and 15% to the general partner, until each unitholder receives a total of \$0.656 per unit for that quarter (the second target distribution );

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*Third*, 75% to all unitholders, pro rata, and 25% to the general partner, until each unitholder receives a total of \$0.788 per unit for that quarter (the third target distribution ); and

*Thereafter*, 50% to all unitholders, pro rata, and 50% to the general partner.

In each case, the amount of the target distribution set forth above is exclusive of any distributions to common unitholders to eliminate any cumulative arrearages in payment of the minimum quarterly distribution.

**Percentage Allocations of Available Cash From Operating Surplus**

The following table illustrates the percentage allocations of the additional available cash from operating surplus between the unitholders and our general partner up to the various target distribution levels. The amounts set forth under *Marginal Percentage Interest in Distributions* are the percentage interests of our general partner and the unitholders in any available cash from operating surplus we distribute up to and including the corresponding amount in the column *Total Quarterly Distribution Target Amount*, until available cash from operating surplus we distribute reaches the next target distribution level, if any. The percentage interests shown for the unitholders and the general partner for the minimum quarterly distribution are also applicable to quarterly distribution amounts that are less than the minimum quarterly distribution.

|                                | <b>Total Quarterly Distribution<br/>Target Amount</b> | <b>Marginal Percentage Interest<br/>In Distributions</b> |                            |
|--------------------------------|---|--|----------------------------|
|                                |   | <b>Unitholders</b>                                       | <b>General<br/>Partner</b> |
| Minimum Quarterly Distribution | \$0.525   | 98%  | 2%                         |
| First Target Distribution      | up to \$0.578   | 98%  | 2%                         |
| Second Target Distribution     | above \$0.578 up to<br>\$0.656                        | 85%  | 15%                        |
| Third Target Distribution      | above \$0.656 up to<br>\$0.788                        | 75%  | 25%                        |
| Thereafter                     | above \$0.788   | 50%  | 50%                        |

**Distributions From Capital Surplus**

*How Distributions from Capital Surplus Will Be Made.* We will make distributions of available cash from capital surplus in the following manner:

*First*, 98% to all unitholders, pro rata, and 2% to the general partner, until we distribute for each common unit, an amount of available cash from capital surplus equal to the initial public offering price;

*Second*, 98% to the common unitholders and Class B common unitholders pro rata, and 2% to the general partner, until we distribute for each common unit that was issued in the offering, an amount of available cash from capital surplus equal to any unpaid arrearages

in payment of the minimum quarterly distribution on the common units; and

*Thereafter*, we will make all distributions of available cash from capital surplus as if they were from operating surplus.

*Effect of a Distribution from Capital Surplus.* The partnership agreement treats a distribution of capital surplus as the repayment of the unit price from our initial public offering, which is a return of capital. The initial public offering price less any distributions of capital surplus per unit is referred to as the unrecovered initial unit

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price. Each time a distribution of capital surplus is made, the minimum quarterly distribution and the target distribution levels will be reduced in the same proportion as the corresponding reduction in the unrecovered initial unit price. Because distributions of capital surplus will reduce the minimum quarterly distribution, after any of these distributions are made, it may be easier for the general partner to receive incentive distributions and for the subordinated units to convert into common units. However, any distribution of capital surplus before the unrecovered initial unit price is reduced to zero cannot be applied to the payment of the minimum quarterly distribution or any arrearages.

Once we distribute capital surplus on a unit issued in this offering in an amount equal to the initial unit price, we will reduce the minimum quarterly distribution and the target distribution levels to zero and we will make all future distributions from operating surplus, with 50% being paid to the holders of units, 48% to the holders of the incentive distribution rights and 2% to the general partner.

## **Adjustment to the Minimum Quarterly Distribution and Target Distribution Levels**

In addition to adjusting the minimum quarterly distribution and target distribution levels to reflect a distribution of capital surplus, if we combine our units into fewer units or subdivide our units into a greater number of units, we will proportionately adjust:

the minimum quarterly distribution;

target distribution levels;

unrecovered initial unit price;

the number of common units issuable during the subordination period without a unitholder vote; and

the number of common units into which a subordinated unit is convertible.

For example, if a two-for-one split of the common units should occur, the minimum quarterly distribution, the target distribution levels and the unrecovered initial unit price would each be reduced to 50% of its initial level. We will not make any adjustment by reason of the issuance of additional units for cash or property.

In addition, if legislation is enacted or if existing law is modified or interpreted in a manner that causes us to become taxable as a corporation or otherwise subject to taxation as an entity for federal, state or local income tax purposes, we will reduce the minimum quarterly distribution and the target distribution levels by multiplying the same by one minus the sum of the highest marginal federal corporate income tax rate that could apply and any increase in the effective overall state and local income tax rates. For example, if we became subject to a maximum marginal federal, and effective state and local income tax rate of 38%, then the minimum quarterly distribution and the target distributions levels would each be reduced to 62% of their previous levels.

## **Distributions of Cash Upon Liquidation**



If we dissolve in accordance with the partnership agreement, we will sell or otherwise dispose of our assets in a process called a liquidation. We will first apply the proceeds of liquidation to the payment of our creditors. We will distribute any remaining proceeds to the unitholders and the general partner, in accordance with their capital account balances, as adjusted to reflect any gain or loss upon the sale or other disposition of our assets in liquidation.

The allocations of gain and loss upon liquidation are intended, to the extent possible, to entitle the holders of outstanding common units and Class B common units to a preference over the holders of outstanding subordinated units upon our liquidation, to the extent required to permit common unitholders and Class B common unitholders to receive their unrecovered initial unit price plus the minimum quarterly distribution for the quarter during which liquidation occurs plus any unpaid arrearages in payment of the minimum quarterly distribution on the common units and Class B common units. However, there may not be sufficient gain upon our liquidation to enable the

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holder of common units or Class B common units to fully recover all of these amounts, even though there may be cash available for distribution to the holders of subordinated units. Any further net gain recognized upon liquidation will be allocated in a manner that takes into account the incentive distribution rights of the general partner.

*Manner of Adjustments for Gain.* The manner of the adjustment is set forth in the partnership agreement. If our liquidation occurs before the end of the subordination period, we will allocate any gain to the partners in the following manner:

*First*, to the general partner and the holders of units who have negative balances in their capital accounts to the extent of and in proportion to those negative balances;

*Second*, 98% to the common unitholders and Class B common unitholders, pro rata, and 2% to the general partner, until the capital account for each common unit is equal to the sum of:

- (1) the unrecovered initial unit price for that common unit; plus
- (2) the amount of the minimum quarterly distribution for the quarter during which our liquidation occurs; plus
- (3) any unpaid arrearages in payment of the minimum quarterly distribution on that common unit;

*Third*, 98% to the subordinated unitholders, pro rata, and 2% to the general partner, until the capital account for each subordinated unit is equal to the sum of:

- (1) the unrecovered initial unit price on that subordinated unit; and
- (2) the amount of the minimum quarterly distribution for the quarter during which our liquidation occurs;

*Fourth*, 98% to all unitholders, pro rata, and 2% to the general partner, pro rata, until we allocate under this paragraph an amount per unit equal to:

- (1) the sum of the excess of the first target distribution per unit over the minimum quarterly distribution per unit for each quarter of our existence; less
- (2) the cumulative amount per unit of any distributions of available cash from operating surplus in excess of the minimum quarterly distribution per unit that we distributed 98% to the units, pro rata, and 2% to the general partner, pro rata, for each quarter of our existence;

*Fifth*, 85% to all unitholders, pro rata, and 15% to the general partner, until we allocate under this paragraph an amount per unit equal to:

- (1)

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the sum of the excess of the second target distribution per unit over the first target distribution per unit for each quarter of our existence; less

- (2) the cumulative amount per unit of any distributions of available cash from operating surplus in excess of the first target distribution per unit that we distributed 85% to the unitholders, pro rata, and 15% to the general partner for each quarter of our existence;

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*Sixth*, 75% to all unitholders, pro rata, and 25% to the general partner, until we allocate under this paragraph an amount per unit equal to:

- (1) the sum of the excess of the third target distribution per unit over the second target distribution per unit for each quarter of our existence; less
- (2) the cumulative amount per unit of any distributions of available cash from operating surplus in excess of the second target distribution per unit that we distributed 75% to the unitholders, pro rata, and 25% to the general partner for each quarter of our existence;

*Thereafter*, 50% to all unitholders, pro rata, and 50% to the general partner.

If the liquidation occurs after the end of the subordination period, the distinction between common units and subordinated units will disappear, so that clause (3) of the second bullet point above and all of the third bullet point above will no longer be applicable.

*Manner of Adjustments for Losses.* Upon our liquidation, we will generally allocate any loss to the general partner and the unitholders in the following manner:

*First*, 98% to holders of subordinated units in proportion to the positive balances in their capital accounts and 2% to the general partner until the capital accounts of the holders of the subordinated units have been reduced to zero;

*Second*, 98% to the holders of common units and Class B common units in proportion to the positive balances in their capital accounts and 2% to the general partner until the capital accounts of the common unitholders and Class B common unitholders have been reduced to zero; and

*Thereafter*, 100% to the general partner.

If the liquidation occurs after the end of the subordination period, the distinction between common units, Class B common units and subordinated units will disappear, so that all of the first bullet point above will no longer be applicable.

*Adjustments to Capital Accounts.* We will make adjustments to capital accounts upon the issuance of additional units. In doing so, we will allocate any unrealized and, for tax purposes, unrecognized gain or loss resulting from the adjustments to the unitholders and the general partner in the same manner as we allocate gain or loss upon liquidation. In the event that we make positive adjustments to the capital accounts upon the issuance of additional units, we will allocate any later negative adjustments to the capital accounts resulting from the issuance of additional units or upon our liquidation in a manner which results, to the extent possible, in the general partner's capital account balances equaling the amount which they would have been if no earlier positive adjustments to the capital accounts had been made.

**MATERIAL TAX CONSEQUENCES**

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This section is a summary of the material tax consequences that may be relevant to prospective unitholders who are individual citizens or residents of the United States and, unless otherwise noted in the following discussion, is the opinion of Vinson & Elkins L.L.P., counsel to the general partner and us, insofar as it relates to federal income tax matters. This section is based upon current provisions of the Internal Revenue Code, existing and proposed regulations and current administrative rulings and court decisions, all of which are subject to change. Later changes in these authorities may cause the tax consequences to vary substantially from the consequences described below. Unless the context otherwise requires, references in this section to us or we are references to Magellan Midstream Partners.

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This section does not comment on all federal income tax matters affecting us or the unitholders. Moreover, the discussion focuses on unitholders who are individual citizens or residents of the United States and has only limited application to corporations, estates, trusts, nonresident aliens or other unitholders subject to specialized tax treatment, such as tax-exempt institutions, foreign persons, individual retirement accounts (IRAs), real estate investment trusts (REITs) or mutual funds. Accordingly, we recommend that each prospective unitholder consult, and depend on, his own tax advisor in analyzing the federal, state, local and foreign tax consequences particular to him of the ownership or disposition of common units.

All statements as to matters of law and legal conclusions, but not as to factual matters, contained in this section, unless otherwise noted, are the opinion of Vinson & Elkins L.L.P. and are based on the accuracy of the representations we make. An opinion of counsel represents only that counsel's best legal judgment and does not bind the IRS or the courts. Accordingly, the opinions and statements made here may not be sustained by a court if contested by the IRS. Any contest of this sort with the IRS may materially and adversely impact the market for the common units and the prices at which common units trade. In addition, the costs of any contest with the IRS will be borne directly or indirectly by the unitholders and the general partner. Furthermore, the tax treatment of us, or of an investment in us, may be significantly modified by future legislative or administrative changes or court decisions. Any modifications may or may not be retroactively applied.

For the reasons described below, Vinson & Elkins L.L.P. has not rendered an opinion with respect to the following specific federal income tax issues:

- (1) the treatment of a unitholder whose common units are loaned to a short seller to cover a short sale of common units (please read Tax Consequences of Unit Ownership Treatment of Short Sales );
- (2) whether our monthly convention for allocating taxable income and losses is permitted by existing Treasury regulations (please read Disposition of Common Units Allocations Between Transferors and Transferees ); and
- (3) whether our method for depreciating Section 743 adjustments is sustainable (please read Tax Consequences of Unit Ownership Section 754 Election ).

## **Partnership Status**

A partnership is not a taxable entity and incurs no federal income tax liability. Instead, each partner of a partnership is required to take into account his share of items of income, gain, loss and deduction of the partnership in computing his federal income tax liability, regardless of whether cash distributions are made to him by the partnership. Distributions by a partnership to a partner are generally not taxable unless the amount of cash distributed is in excess of the partner's adjusted basis in his partnership interest.

Section 7704 of the Internal Revenue Code provides that publicly-traded partnerships will, as a general rule, be taxed as corporations. However, an exception, referred to as the Qualifying Income Exception, exists with respect to publicly-traded partnerships of which 90% or more of the gross income for every taxable year consists of qualifying income. Qualifying income includes income and gains derived from the transportation, storage and processing of crude oil, natural gas and products thereof and fertilizer. Other types of qualifying income include interest (other than from a financial business), dividends, gains from the sale of real property and gains from the sale or other disposition of assets held for the production of income that otherwise constitutes qualifying income. We estimate that less than 8% of our current income is not qualifying income; however, this estimate could change from time to time. Based upon and subject to this estimate, the factual representations made by us and the general partner and a review of the applicable legal authorities, Vinson & Elkins L.L.P. is of the opinion that at least 90% of our current gross income constitutes qualifying income.

The IRS has made no determination as to our status as partnerships for federal income tax purposes. Instead, we will rely on the opinion of Vinson & Elkins L.L.P. that, based upon the Internal Revenue Code, its regulations,

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published revenue rulings and court decisions and the representations described below, Magellan Midstream Partners will be classified as a partnership for federal income tax purposes.

In rendering its opinion, Vinson & Elkins L.L.P. has relied on factual representations made by us and our general partner. The representations made by us and our general partner upon which counsel has relied are:

- (a) Neither we nor the operating partnership has elected or will elect to be treated as a corporation; and
- (b) For each taxable year, more than 90% of our gross income has been and will be income that our counsel has opined or will opine is qualifying income within the meaning of Section 7704(d) of the Internal Revenue Code.

If we fail to meet the Qualifying Income Exception, other than a failure which is determined by the IRS to be inadvertent and which is cured within a reasonable time after discovery, we will be treated as if we had transferred all of our assets, subject to liabilities, to a newly formed corporation, on the first day of the year in which we fail to meet the Qualifying Income Exception, in return for stock in that corporation, and then distributed that stock to the unitholders in liquidation of their interests in us. This contribution and liquidation should be tax-free to unitholders and us so long as we, at that time, do not have liabilities in excess of the tax basis of our assets. Thereafter, we would be treated as a corporation for federal income tax purposes.

If we were taxable as a corporation in any taxable year, either as a result of a failure to meet the Qualifying Income Exception or otherwise, our items of income, gain, loss and deduction would be reflected only on our tax return rather than being passed through to the unitholders, and our net income would be taxed to us at corporate rates. In addition, any distribution made to a unitholder would be treated as either taxable dividend income, to the extent of our current or accumulated earnings and profits, or, in the absence of earnings and profits, a nontaxable return of capital, to the extent of the unitholder's tax basis in his common units, or taxable capital gain, after the unitholder's tax basis in his common units is reduced to zero. Accordingly, taxation as a corporation would result in a material reduction in a unitholder's cash flow and after-tax return and thus would likely result in a substantial reduction of the value of the units.

The remainder of this section is based on Vinson & Elkins L.L.P.'s opinion that Magellan Midstream Partners will be classified as a partnership for federal income tax purposes.

## **Limited Partner Status**

Unitholders who have become limited partners of Magellan Midstream Partners will be treated as partners of Magellan Midstream Partners for federal income tax purposes. Also:

- (a) assignees who have executed and delivered transfer applications, and are awaiting admission as limited partners, and
- (b) unitholders whose common units are held in street name or by a nominee and who have the right to direct the nominee in the exercise of all substantive rights attendant to the ownership of their common units, will be treated as partners of Magellan Midstream Partners for federal income tax purposes.



As there is no direct authority addressing assignees of common units who are entitled to execute and deliver transfer applications and become entitled to direct the exercise of attendant rights, but who fail to execute and deliver transfer applications, the opinion of Vinson & Elkins L.L.P. does not extend to these persons. Furthermore, a purchaser or other transferee of common units who does not execute and deliver a transfer application may not receive some federal income tax information or reports furnished to record holders of common units unless the common units are held in a nominee or street name account and the nominee or broker has executed and delivered a transfer application for those common units.

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A beneficial owner of common units whose units have been transferred to a short seller to complete a short sale would appear to lose his status as a partner with respect to those units for federal income tax purposes. Please read [Tax Consequences of Unit Ownership](#) [Treatment of Short Sales](#).

Income, gain, deductions or losses would not appear to be reportable by a unitholder who is not a partner for federal income tax purposes, and any cash distributions received by a unitholder who is not a partner for federal income tax purposes would therefore be fully taxable as ordinary income. These holders are urged to consult their own tax advisors with respect to their status as partners in Magellan Midstream Partners for federal income tax purposes.

## **Tax Consequences of Unit Ownership**

*Flow-through of Taxable Income.* We will not pay any federal income tax. Instead, each unitholder will be required to report on his income tax return his share of our income, gains, losses and deductions without regard to whether corresponding cash distributions are received by him. Consequently, we may allocate income to a unitholder even if he has not received a cash distribution. Each unitholder will be required to include in income his allocable share of our income, gains, losses and deductions for our taxable year ending with or within his taxable year. Our taxable year ends on December 31.

*Treatment of Distributions.* Distributions by us to a unitholder generally will not be taxable to the unitholder for federal income tax purposes to the extent of his tax basis in his common units immediately before the distribution. Our cash distributions in excess of a unitholder's tax basis generally will be considered to be gain from the sale or exchange of the common units, taxable in accordance with the rules described under [Disposition of Common Units](#) below. Any reduction in a unitholder's share of our liabilities for which no partner, including the general partner, bears the economic risk of loss, known as nonrecourse liabilities, will be treated as a distribution of cash to that unitholder. To the extent our distributions cause a unitholder's at risk amount to be less than zero at the end of any taxable year, he must recapture any losses deducted in previous years. Please read [Limitations on Deductibility of Losses](#).

A decrease in a unitholder's percentage interest in us because of our issuance of additional common units will decrease his share of our nonrecourse liabilities, and thus will result in a corresponding deemed distribution of cash. A non-pro rata distribution of money or property may result in ordinary income to a unitholder, regardless of his tax basis in his common units, if the distribution reduces the unitholder's share of our unrealized receivables, including depreciation recapture, and/or substantially appreciated inventory items, both as defined in the Internal Revenue Code, and collectively, Section 751 Assets. To that extent, he will be treated as having been distributed his proportionate share of the Section 751 Assets and having exchanged those assets with us in return for the non-pro rata portion of the actual distribution made to him. This latter deemed exchange will generally result in the unitholder's realization of ordinary income. That income will equal the excess of (1) the non-pro rata portion of that distribution over (2) the unitholder's tax basis for the share of Section 751 Assets deemed relinquished in the exchange.

*Basis of Common Units.* A unitholder's initial tax basis for his common units will be the amount he paid for the common units plus his share of our nonrecourse liabilities. That basis will be increased by his share of our income and by any increases in his share of our nonrecourse liabilities. That basis will be decreased, but not below zero, by distributions from us, by the unitholder's share of our losses, by any decreases in his share of our nonrecourse liabilities and by his share of our expenditures that are not deductible in computing taxable income and are not required to be capitalized. A unitholder will have no share of our debt which is recourse to the general partner, but will have a share, generally based on his share of profits, of our nonrecourse liabilities. Please read [Disposition of Common Units](#) [Recognition of Gain or Loss](#).

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*Limitations on Deductibility of Losses.* The deduction by a unitholder of his share of our losses will be limited to the tax basis in his units and, in the case of an individual unitholder or a corporate unitholder, if more than 50% of the value of the corporate unitholder's stock is owned directly or indirectly by five or fewer individuals or some tax-exempt organizations, to the amount for which the unitholder is considered to be at risk with respect to our

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activities, if that is less than his tax basis. A unitholder must recapture losses deducted in previous years to the extent that distributions cause his at risk amount to be less than zero at the end of any taxable year. Losses disallowed to a unitholder or recaptured as a result of these limitations will carry forward and will be allowable to the extent that his tax basis or at risk amount, whichever is the limiting factor, is subsequently increased. Upon the taxable disposition of a unit, any gain recognized by a unitholder can be offset by losses that were previously suspended by the at risk limitation but may not be offset by losses suspended by the basis limitation. Any excess loss above that gain previously suspended by the at risk or basis limitations is no longer utilizable.

In general, a unitholder will be at risk to the extent of the tax basis of his units, excluding any portion of that basis attributable to his share of our nonrecourse liabilities, reduced by any amount of money he borrows to acquire or hold his units, if the lender of those borrowed funds owns an interest in us, is related to the unitholder or can look only to the units for repayment. A unitholder's at risk amount will increase or decrease as the tax basis of the unitholder's units increases or decreases, other than tax basis increases or decreases attributable to increases or decreases in his share of our nonrecourse liabilities.

The passive loss limitations generally provide that individuals, estates, trusts and some closely-held corporations and personal service corporations can deduct losses from passive activities, which are generally activities in which the taxpayer does not materially participate, only to the extent of the taxpayer's income from those passive activities. The passive loss limitations are applied separately with respect to each publicly-traded partnership. Consequently, any losses we generate will only be available to offset our passive income generated in the future and will not be available to offset income from other passive activities or investments, including our investments or investments in other publicly-traded partnerships, or salary or active business income. Passive losses that are not deductible because they exceed a unitholder's share of income we generate may be deducted in full when he disposes of his entire investment in us in a fully taxable transaction with an unrelated party. The passive activity loss rules are applied after other applicable limitations on deductions, including the at risk rules and the basis limitation.

A unitholder's share of our net income may be offset by any suspended passive losses, but it may not be offset by any other current or carryover losses from other passive activities, including those attributable to other publicly-traded partnerships.

*Limitations on Interest Deductions.* The deductibility of a non-corporate taxpayer's investment interest expense is generally limited to the amount of that taxpayer's net investment income. Investment interest expense includes:

interest on indebtedness properly allocable to property held for investment;

our interest expense attributed to portfolio income; and

the portion of interest expense incurred to purchase or carry an interest in a passive activity to the extent attributable to portfolio income.

The computation of a unitholder's investment interest expense will take into account interest on any margin account borrowing or other loan incurred to purchase or carry a unit. Net investment income includes gross income from property held for investment and amounts treated as portfolio income under the passive loss rules, less deductible expenses, other than interest, directly connected with the production of investment income, but generally does not include gains attributable to the disposition of property held for investment. The IRS has indicated that net passive income from a publicly-traded partnership constitutes investment income for purposes of the limitations on the deductibility of investment interest. In addition, the unitholder's share of our portfolio income will be treated as investment income.

*Entity-Level Collections.* If we are required or elect under applicable law to pay any federal, state or local income tax on behalf of any unitholder or the general partner or any former unitholder, we are authorized to pay those taxes from our funds. That payment, if made, will be treated as a distribution of cash to the partner on whose

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behalf the payment was made. If the payment is made on behalf of a person whose identity cannot be determined, we are authorized to treat the payment as a distribution to all current unitholders. We are authorized to amend the partnership agreement in the manner necessary to maintain uniformity of intrinsic tax characteristics of units and to adjust later distributions, so that after giving effect to these distributions, the priority and characterization of distributions otherwise applicable under the partnership agreement is maintained as nearly as is practicable. Payments by us as described above could give rise to an overpayment of tax on behalf of an individual partner in which event the partner would be required to file a claim in order to obtain a credit or refund.

*Allocation of Income, Gain, Loss and Deduction.* In general, if we have a net profit, our items of income, gain, loss and deduction will be allocated among the general partner and the unitholders in accordance with their percentage interests in us. At any time that distributions are made to the common units in excess of distributions to the subordinated units, or incentive distributions are made to the general partner, gross income will be allocated to the recipients to the extent of these distributions. If we have a net loss for the entire year, that loss will be allocated first to the general partner and the unitholders in accordance with their percentage interests in us to the extent of their positive capital accounts and, second, to the general partner.

Specified items of our income, gain, loss and deduction will be allocated to account for the difference between the tax basis and fair market value of our assets at the time of an offering, referred to in this discussion as *Contributed Property*. The effect of these allocations to a unitholder purchasing common units in our offering will be essentially the same as if the tax basis of our assets were equal to their fair market value at the time of the offering. In addition, items of recapture income will be allocated to the extent possible to the partner who was allocated the deduction giving rise to the treatment of that gain as recapture income in order to minimize the recognition of ordinary income by some unitholders. Finally, although we do not expect that our operations will result in the creation of negative capital accounts, if negative capital accounts nevertheless result, items of our income and gain will be allocated in an amount and manner to eliminate the negative balance as quickly as possible.

An allocation of items of our income, gain, loss or deduction, other than an allocation required by the Internal Revenue Code to eliminate the difference between a partner's book capital account, credited with the fair market value of *Contributed Property*, and tax capital account, credited with the tax basis of *Contributed Property*, referred to in this discussion as the *Book-Tax Disparity*, will generally be given effect for federal income tax purposes in determining a partner's share of an item of income, gain, loss or deduction only if the allocation has substantial economic effect. In any other case, a partner's share of an item will be determined on the basis of his interest in us, which will be determined by taking into account all the facts and circumstances, including his relative contributions to us, the interests of all the partners in profits and losses, the interest of all the partners in cash flow and other nonliquidating distributions and rights of all the partners to distributions of capital upon liquidation.

Vinson & Elkins L.L.P. is of the opinion that, with the exception of the issues described in *Tax Consequences of Unit Ownership Section 754 Election and Disposition of Common Units Allocations Between Transferors and Transferees*, allocations under our partnership agreement will be given effect for federal income tax purposes in determining a partner's share of an item of income, gain, loss or deduction.

*Treatment of Short Sales.* A unitholder whose units are loaned to a short seller to cover a short sale of units may be considered as having disposed of those units. If so, he would no longer be a partner for those units during the period of the loan and may recognize gain or loss from the disposition. As a result, during this period:

any of our income, gain, loss or deduction with respect to those units would not be reportable by the unitholder;

any cash distributions received by the unitholder as to those units would be fully taxable; and

all of these distributions would appear to be ordinary income.

Vinson & Elkins L.L.P. has not rendered an opinion regarding the treatment of a unitholder where common units are loaned to a short seller to cover a short sale of common units; therefore, unitholders desiring to assure their

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status as partners and avoid the risk of gain recognition from a loan to a short seller should modify any applicable brokerage account agreements to prohibit their brokers from borrowing their units. The IRS has announced that it is actively studying issues relating to the tax treatment of short sales of partnership interests. Please also read [Disposition of Common Units](#) [Recognition of Gain or Loss](#).

*Alternative Minimum Tax.* Each unitholder will be required to take into account his distributive share of any items of our income, gain, loss or deduction for purposes of the alternative minimum tax. The current minimum tax rate for noncorporate taxpayers is 26% on the first \$175,000 of alternative minimum taxable income in excess of the exemption amount and 28% on any additional alternative minimum taxable income. Prospective unitholders are urged to consult with their tax advisors as to the impact of an investment in units on their liability for the alternative minimum tax.

*Tax Rates.* In general, the highest effective United States federal income tax rate for individuals currently is 35% and the maximum United States federal income tax rate for net capital gains of an individual currently is 15% if the asset disposed of was held for more than 12 months at the time of disposition.

*Section 754 Election.* We have made the election permitted by Section 754 of the Internal Revenue Code. That election is irrevocable without the consent of the IRS. The election will generally permit us to adjust a common unit purchaser's tax basis in our assets ( *inside basis* ) under Section 743(b) of the Internal Revenue Code to reflect his purchase price. This election does not apply to a person who purchases common units directly from us. The Section 743(b) adjustment belongs to the purchaser and not to other partners. For purposes of this discussion, a partner's *inside basis* in our assets will be considered to have two components: (1) his share of our tax basis in our assets ( *common basis* ) and (2) his Section 743(b) adjustment to that basis.

Treasury regulations under Section 743 of the Internal Revenue Code require, if the remedial allocation method is adopted (which we have adopted), a portion of the Section 743(b) adjustment attributable to recovery property to be depreciated over the remaining cost recovery period for the Section 704(c) built-in gain. Under Treasury Regulation Section 1.167(c)-1(a)(6), a Section 743(b) adjustment attributable to property subject to depreciation under Section 167 of the Internal Revenue Code rather than cost recovery deductions under Section 168 is generally required to be depreciated using either the straight-line method or the 150% declining balance method. Under our partnership agreement, the general partner is authorized to take a position to preserve the uniformity of units even if that position is not consistent with these Treasury regulations. Please read [Tax Treatment of Operations](#) [Uniformity of Units](#).

Although Vinson & Elkins L.L.P. is unable to opine as to the validity of this approach because there is no clear authority on this issue, we intend to depreciate the portion of a Section 743(b) adjustment attributable to unrealized appreciation in the value of Contributed Property, to the extent of any unamortized Book-Tax Disparity, using a rate of depreciation or amortization derived from the depreciation or amortization method and useful life applied to the common basis of the property, or treat that portion as non-amortizable to the extent attributable to property the common basis of which is not amortizable. This method is consistent with the regulations under Section 743 but is arguably inconsistent with Treasury Regulation Section 1.167(c)-1(a)(6), which is not expected to directly apply to a material portion of our assets. To the extent this Section 743(b) adjustment is attributable to appreciation in value in excess of the unamortized Book-Tax Disparity, we will apply the rules described in the Treasury regulations and legislative history. If we determine that this position cannot reasonably be taken, we may take a depreciation or amortization position under which all purchasers acquiring units in the same month would receive depreciation or amortization, whether attributable to common basis or a Section 743(b) adjustment, based upon the same applicable rate as if they had purchased a direct interest in our assets. This kind of aggregate approach may result in lower annual depreciation or amortization deductions than would otherwise be allowable to some unitholders. Please read [Tax Treatment of Operations](#) [Uniformity of Units](#).

A Section 754 election is advantageous if the transferee's tax basis in his units is higher than the units' share of the aggregate tax basis of our assets immediately prior to the transfer. In that case, as a result of the election, the transferee would have, among other items, a greater amount



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of depreciation and depletion deductions and his share of any gain on a sale of our assets would be less. Conversely, a Section 754 election is disadvantageous if the transferee's tax basis in his units is lower than those units' share of the aggregate tax basis of our assets immediately

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prior to the transfer. Thus, the fair market value of the units may be affected either favorably or unfavorably by the election.

The calculations involved in the Section 754 election are complex and will be made on the basis of assumptions as to the value of our assets and other matters. For example, the allocation of the Section 743(b) adjustment among our assets must be made in accordance with the Internal Revenue Code. The IRS could seek to reallocate some or all of any Section 743(b) adjustment we allocated to our tangible assets to goodwill instead. Goodwill, as an intangible asset, is generally amortizable over a longer period of time or under a less accelerated method than our tangible assets. We cannot assure you that the determinations we make will not be successfully challenged by the IRS and that the deductions resulting from them will not be reduced or disallowed altogether. Should the IRS require a different basis adjustment to be made, and should, in our opinion, the expense of compliance exceed the benefit of the election, we may seek permission from the IRS to revoke our Section 754 election. If permission is granted, a subsequent purchaser of units may be allocated more income than he would have been allocated had the election not been revoked.

## **Tax Treatment of Operations**

*Accounting Method and Taxable Year.* We use the year ending December 31 as our taxable year and the accrual method of accounting for federal income tax purposes. Each unitholder will be required to include in income his share of our income, gain, loss and deduction for our taxable year ending within or with his taxable year. In addition, a unitholder who has a taxable year ending on a date other than December 31 and who disposes of all of his units following the close of our taxable year but before the close of his taxable year must include his share of our income, gain, loss and deduction in income for his taxable year, with the result that he will be required to include in income for his taxable year his share of more than one year of our income, gain, loss and deduction. Please read [Disposition of Common Units](#) [Allocations Between Transferors and Transferees](#).

*Tax Basis, Depreciation and Amortization.* The tax basis of our assets will be used for purposes of computing depreciation and cost recovery deductions and, ultimately, gain or loss on the disposition of these assets. The federal income tax burden associated with the difference between the fair market value of our assets and their tax basis immediately prior to an offering will be borne by the general partner, its affiliates and our other unitholders as of that time. Please read [Tax Consequences of Unit Ownership](#) [Allocation of Income, Gain, Loss and Deduction](#).

To the extent allowable, we may elect to use the depreciation and cost recovery methods that will result in the largest deductions being taken in the early years after assets are placed in service. We were not entitled to any amortization deductions with respect to any goodwill conveyed to us on formation. Property we subsequently acquire or construct may be depreciated using accelerated methods permitted by the Internal Revenue Code.

If we dispose of depreciable property by sale, foreclosure, or otherwise, all or a portion of any gain, determined by reference to the amount of depreciation previously deducted and the nature of the property, may be subject to the recapture rules and taxed as ordinary income rather than capital gain. Similarly, a partner who has taken cost recovery or depreciation deductions with respect to property we own will likely be required to recapture some or all of those deductions as ordinary income upon a sale of his interest in us. Please read [Tax Consequences of Unit Ownership](#) [Allocation of Income, Gain, Loss and Deduction](#) and [Disposition of Common Units](#) [Recognition of Gain or Loss](#).

The costs incurred in selling our units (called [syndication expenses](#) ) must be capitalized and cannot be deducted currently, ratably or upon our termination. There are uncertainties regarding the classification of costs as organization expenses, which we may amortize, and as syndication expenses, which we may not amortize. The underwriting discounts and commissions we incur will be treated as syndication expenses.

*Valuation and Tax Basis of Our Properties.* The federal income tax consequences of the ownership and disposition of units will depend in part on our estimates of the relative fair market values, and the tax bases, of our assets. Although we may from time to time consult with professional appraisers regarding valuation matters, we will make many of the relative fair market value estimates ourselves. These estimates of basis are subject to challenge

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and will not be binding on the IRS or the courts. If the estimates of fair market value or basis are later found to be incorrect, the character and amount of items of income, gain, loss or deductions previously reported by unitholders might change, and unitholders might be required to adjust their tax liability for prior years and incur interest and penalties with respect to those adjustments.

### **Disposition of Common Units**

*Recognition of Gain or Loss.* Gain or loss will be recognized on a sale of units equal to the difference between the amount realized and the unitholder's tax basis for the units sold. A unitholder's amount realized will be measured by the sum of the cash or the fair market value of other property he receives plus his share of our nonrecourse liabilities. Because the amount realized includes a unitholder's share of our nonrecourse liabilities, the gain recognized on the sale of units could result in a tax liability in excess of any cash received from the sale.

Prior distributions from us in excess of cumulative net taxable income for a common unit that decreased a unitholder's tax basis in that common unit will, in effect, become taxable income if the common unit is sold at a price greater than the unitholder's tax basis in that common unit, even if the price received is less than his original cost.

Except as noted below, gain or loss recognized by a unitholder, other than a dealer in units, on the sale or exchange of a unit held for more than one year will generally be taxable as capital gain or loss. Capital gain recognized by an individual on the sale of units held more than 12 months will generally be taxed at a maximum rate of 15%. A portion of this gain or loss, which will likely be substantial, however, will be separately computed and taxed as ordinary income or loss under Section 751 of the Internal Revenue Code to the extent attributable to assets giving rise to depreciation recapture or other unrealized receivables or to inventory items we own. The term unrealized receivables includes potential recapture items, including depreciation recapture. Ordinary income attributable to unrealized receivables, inventory items and depreciation recapture may exceed net taxable gain realized upon the sale of a unit and may be recognized even if there is a net taxable loss realized on the sale of a unit. Thus, a unitholder may recognize both ordinary income and a capital loss upon a sale of units. Net capital loss may offset capital gains and no more than \$3,000 of ordinary income, in the case of individuals, and may only be used to offset capital gain in the case of corporations.

The IRS has ruled that a partner who acquires interests in a partnership in separate transactions must combine those interests and maintain a single adjusted tax basis for all those interests. Upon a sale or other disposition of less than all of those interests, a portion of that tax basis must be allocated to the interests sold using an equitable apportionment method. Treasury regulations allow a selling unitholder who can identify common units transferred with an ascertainable holding period to elect to use the actual holding period of the common units transferred. Thus, according to the ruling, a common unitholder will be unable to select high or low basis common units to sell as would be the case with corporate stock, but, according to the regulations, may designate specific common units sold for purposes of determining the holding period of units transferred. A unitholder electing to use the actual holding period of common units transferred must consistently use that identification method for all subsequent sales or exchanges of common units. A unitholder considering the purchase of additional units or a sale of common units purchased in separate transactions is urged to consult his tax advisor as to the possible consequences of this ruling and application of the Treasury regulations.

Specific provisions of the Internal Revenue Code affect the taxation of some financial products and securities, including partnership interests, by treating a taxpayer as having sold an appreciated partnership interest, one in which gain would be recognized if it were sold, assigned or terminated at its fair market value, if the taxpayer or related persons enter(s) into:

a short sale;

an offsetting notional principal contract; or

a futures or forward contract with respect to the partnership interest or substantially identical property.

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Moreover, if a taxpayer has previously entered into a short sale, an offsetting notional principal contract or futures or forward contract with respect to the partnership interest, the taxpayer will be treated as having sold that position if the taxpayer or a related person then acquires the partnership interest or substantially identical property. The Secretary of Treasury is also authorized to issue regulations that treat a taxpayer that enters into transactions or positions that have substantially the same effect as the preceding transactions as having constructively sold the financial position.

*Allocations Between Transferors and Transferees.* In general, our taxable income and losses will be determined annually, will be prorated on a monthly basis and will be subsequently apportioned among the unitholders in proportion to the number of units owned by each of them as of the opening of the applicable exchange on the first business day of the month (the Allocation Date). However, gain or loss realized on a sale or other disposition of our assets other than in the ordinary course of business will be allocated among the unitholders on the Allocation Date in the month in which that gain or loss is recognized. As a result, a unitholder transferring units may be allocated income, gain, loss and deduction realized after the date of transfer.

The use of this method may not be permitted under existing Treasury regulations. Accordingly, Vinson & Elkins L.L.P. is unable to opine on the validity of this method of allocating income and deductions between unitholders. If this method is not allowed under the Treasury regulations, or only applies to transfers of less than all of the unitholder's interest, our taxable income or losses might be reallocated among the unitholders. We are authorized to revise our method of allocation between unitholders to conform to a method permitted under future Treasury regulations.

A unitholder who owns units at any time during a quarter and who disposes of them prior to the record date set for a cash distribution for that quarter will be allocated items of our income, gain, loss and deductions attributable to that quarter but will not be entitled to receive that cash distribution.

*Notification Requirements.* A purchaser of units from another unitholder is required to notify us in writing of that purchase within 30 days after the purchase. We are required to notify the IRS of that transaction and to furnish specified information to the transferor and transferee. However, these reporting requirements do not apply to a sale by an individual who is a citizen of the United States and who effects the sale or exchange through a broker.

*Constructive Termination.* We will be considered to have been terminated for tax purposes if there is a sale or exchange of 50% or more of the total interests in our capital and profits within a 12-month period. A constructive termination results in the closing of our taxable year for all unitholders. In the case of a unitholder reporting on a taxable year other than a fiscal year ending December 31, the closing of our taxable year may result in more than 12 months of our taxable income or loss being includable in his taxable income for the year of termination. We would be required to make new tax elections after a termination, including a new election under Section 754 of the Internal Revenue Code, and a termination would result in a deferral of our deductions for depreciation. A termination could also result in penalties if we were unable to determine that the termination had occurred. Moreover, a termination might either accelerate the application of, or subject us to, any tax legislation enacted before the termination.

## **Uniformity of Units**

Because we cannot match transferors and transferees of units, we must maintain uniformity of the economic and tax characteristics of the units to a purchaser of these units. In the absence of uniformity, we may be unable to completely comply with a number of federal income tax requirements, both statutory and regulatory. A lack of uniformity can result from a literal application of Treasury Regulation Section 1.167(c)-1(a)(6). Any non-uniformity could have a negative impact on the value of the units. Please read Tax Consequences of Unit

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Ownership Section 754 Election.

We intend to depreciate the portion of a Section 743(b) adjustment attributable to unrealized appreciation in the value of Contributed Property, to the extent of any unamortized Book-Tax Disparity, using a rate of depreciation or amortization derived from the depreciation or amortization method and useful life applied to the common basis of

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that property, or treat that portion as nonamortizable, to the extent attributable to property the common basis of which is not amortizable, consistent with the regulations under Section 743, even though that position may be inconsistent with Treasury Regulation Section 1.167(c)-1(a)(6) which is not expected to directly apply to a material portion of our assets. Please read [Tax Consequences of Unit Ownership](#) Section 754 Election. To the extent that the Section 743(b) adjustment is attributable to appreciation in value in excess of the unamortized Book-Tax Disparity, we will apply the rules described in the Treasury regulations and legislative history. If we determine that this position cannot reasonably be taken, we may adopt a depreciation and amortization position under which all purchasers acquiring units in the same month would receive depreciation and amortization deductions, whether attributable to a common basis or Section 743(b) adjustment, based upon the same applicable rate as if they had purchased a direct interest in our property. If this position is adopted, it may result in lower annual depreciation and amortization deductions than would otherwise be allowable to some unitholders and risk the loss of depreciation and amortization deductions not taken in the year that these deductions are otherwise allowable. This position will not be adopted if we determine that the loss of depreciation and amortization deductions will have a material adverse effect on the unitholders. If we choose not to utilize this aggregate method, we may use any other reasonable depreciation and amortization method to preserve the uniformity of the intrinsic tax characteristics of any units that would not have a material adverse effect on the unitholders. The IRS may challenge any method of depreciating the Section 743(b) adjustment described in this paragraph. If this challenge were sustained, the uniformity of units might be affected, and the gain from the sale of units might be increased without the benefit of additional deductions. Please read [Disposition of Common Units](#) Recognition of Gain or Loss.

## **Tax-Exempt Organizations and Other Investors**

Ownership of units by employee benefit plans, other tax-exempt organizations, non-resident aliens, foreign corporations, other foreign persons and regulated investment companies raises issues unique to those investors and, as described below, may have substantially adverse tax consequences to them.

Employee benefit plans and most other organizations exempt from federal income tax, including individual retirement accounts and other retirement plans, are subject to federal income tax on unrelated business taxable income. Virtually all of our income allocated to a unitholder which is a tax-exempt organization will be unrelated business taxable income and will be taxable to them.

A regulated investment company or mutual fund is required to derive 90% or more of its gross income from interest, dividends and gains from the sale of stocks or securities or foreign currency or specified related sources. It is not anticipated that any significant amount of our gross income will include that type of income.

Non-resident aliens and foreign corporations, trusts or estates that own units will be considered to be engaged in business in the United States because of the ownership of units. As a consequence they will be required to file federal tax returns to report their share of our income, gain, loss or deduction and pay federal income tax at regular rates on their share of our net income or gain. Under rules applicable to publicly traded partnerships, we will withhold tax, at the highest effective rate applicable to individuals, from cash distributions made quarterly to foreign unitholders. Each foreign unitholder must obtain a taxpayer identification number from the IRS and submit that number to our transfer agent on a Form W-8BEN or applicable substitute form in order to obtain credit for these withholding taxes. A change in applicable law may require us to change these procedures.

In addition, because a foreign corporation that owns units will be treated as engaged in a United States trade or business, that corporation may be subject to the United States branch profits tax at a rate of 30%, in addition to regular federal income tax, on its share of our income and gain, as adjusted for changes in the foreign corporation's U.S. net equity, which are effectively connected with the conduct of a United States trade or business. That tax may be reduced or eliminated by an income tax treaty between the United States and the country in which the foreign corporate unitholder is a qualified resident. In addition, this type of unitholder is subject to special information reporting requirements under



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Section 6038C of the Internal Revenue Code.

Under a ruling of the IRS, a foreign unitholder who sells or otherwise disposes of a unit will be subject to federal income tax on gain realized on the sale or disposition of that unit to the extent that this gain is effectively

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connected with a United States trade or business of the foreign unitholder. Apart from the ruling, a foreign unitholder will not be taxed or subject to withholding upon the sale or disposition of a unit if he has owned less than 5% in value of the units during the five-year period ending on the date of the disposition and if the units are regularly traded on an established securities market at the time of the sale or disposition.

## **Administrative Matters**

*Information Returns and Audit Procedures.* We intend to furnish to each unitholder, within 90 days after the close of each calendar year, specific tax information, including a Schedule K-1, which describes his share of our income, gain, loss and deduction for our preceding taxable year. In preparing this information, which will not be reviewed by counsel, we will take various accounting and reporting positions, some of which have been mentioned earlier, to determine his share of income, gain, loss and deduction. We cannot assure you that those positions will yield a result that conforms to the requirements of the Internal Revenue Code, regulations or administrative interpretations of the IRS. Neither we nor counsel can assure prospective unitholders that the IRS will not successfully contend in court that those positions are impermissible. Any challenge by the IRS could negatively affect the value of the units.

The IRS may audit our federal income tax information returns. Adjustments resulting from an IRS audit may require each unitholder to adjust a prior year's tax liability and possibly may result in an audit of his own return. Any audit of a unitholder's return could result in adjustments not related to our returns as well as those related to our returns.

Partnerships generally are treated as separate entities for purposes of federal tax audits, judicial review of administrative adjustments by the IRS and tax settlement proceedings. The tax treatment of partnership items of income, gain, loss and deduction are determined in a partnership proceeding rather than in separate proceedings with the partners. The Internal Revenue Code requires that one partner be designated as the Tax Matters Partner for these purposes. The partnership agreement names Magellan GP, LLC as our Tax Matters Partner.

The Tax Matters Partner will make some elections on our behalf and on behalf of unitholders. In addition, the Tax Matters Partner can extend the statute of limitations for assessment of tax deficiencies against unitholders for items in our returns. The Tax Matters Partner may bind a unitholder with less than a 1% profits interest in us to a settlement with the IRS unless that unitholder elects, by filing a statement with the IRS, not to give that authority to the Tax Matters Partner. The Tax Matters Partner may seek judicial review, by which all the unitholders are bound, of a final partnership administrative adjustment and, if the Tax Matters Partner fails to seek judicial review, judicial review may be sought by any unitholder having at least a 1% interest in profits or by any group of unitholders having in the aggregate at least a 5% interest in profits. However, only one action for judicial review will go forward, and each unitholder with an interest in the outcome may participate.

A unitholder must file a statement with the IRS identifying the treatment of any item on his federal income tax return that is not consistent with the treatment of the item on our return. Intentional or negligent disregard of this consistency requirement may subject a unitholder to substantial penalties.

*Nominee Reporting.* Persons who hold an interest in us as a nominee for another person are required to furnish to us:

- (a) the name, address and taxpayer identification number of the beneficial owner and the nominee;

(b) whether the beneficial owner is

(1) a person that is not a United States person,

(2) a foreign government, an international organization or any wholly owned agency or instrumentality of either of the foregoing,  
or

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- (3) a tax-exempt entity;
  
- (c) the amount and description of units held, acquired or transferred for the beneficial owner; and
  
- (d) specific information including the dates of acquisitions and transfers, means of acquisitions and transfers, and acquisition cost for purchases, as well as the amount of net proceeds from sales.

Brokers and financial institutions are required to furnish additional information, including whether they are United States persons and specific information on units they acquire, hold or transfer for their own account. A penalty of \$50 per failure, up to a maximum of \$100,000 per calendar year, is imposed by the Internal Revenue Code for failure to report that information to us. The nominee is required to supply the beneficial owner of the units with the information furnished to us.

*Registration as a Tax Shelter.* The Internal Revenue Code requires that tax shelters be registered with the Secretary of the Treasury. It is arguable that we are not subject to the registration requirement on the basis that we will not constitute a tax shelter. However, we have registered as a tax shelter with the Secretary of Treasury in the absence of assurance that we will not be subject to tax shelter registration and in light of the substantial penalties which might be imposed if registration is required and not undertaken. Our tax shelter registration number is 01036000014.

Issuance of this registration number does not indicate that investment in us or the claimed tax benefits have been reviewed, examined or approved by the IRS.

A unitholder who sells or otherwise transfers a unit in a later transaction must furnish the registration number to the transferee. The penalty for failure of the transferor of a unit to furnish the registration number to the transferee is \$100 for each failure. The unitholders must disclose our tax shelter registration number on Form 8271 to be attached to the tax return on which any deduction, loss or other benefit we generate is claimed or on which any of our income is included. A unitholder who fails to disclose the tax shelter registration number on his return, without reasonable cause for that failure, will be subject to a \$250 penalty for each failure. Any penalties discussed are not deductible for federal income tax purposes.

*Accuracy-related Penalties.* An additional tax equal to 20% of the amount of any portion of an underpayment of tax that is attributable to one or more specified causes, including negligence or disregard of rules or regulations, substantial understatements of income tax and substantial valuation misstatements, is imposed by the Internal Revenue Code. No penalty will be imposed, however, for any portion of an underpayment if it is shown that there was a reasonable cause for that portion and that the taxpayer acted in good faith regarding that portion.

A substantial understatement of income tax in any taxable year exists if the amount of the understatement exceeds the greater of 10% of the tax required to be shown on the return for the taxable year or \$5,000 (\$10,000 for most corporations). The amount of any understatement subject to penalty generally is reduced if any portion is attributable to a position adopted on the return:

- (1) for which there is, or was, substantial authority, or
  
- (2) as to which there is a reasonable basis and the pertinent facts of that position are disclosed on the return.

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More stringent rules apply to tax shelters, a term that in this context does not appear to include us. If any item of income, gain, loss or deduction included in the distributive shares of unitholders might result in that kind of an understatement of income for which no substantial authority exists, we must disclose the pertinent facts on our return. In addition, we will make a reasonable effort to furnish sufficient information for unitholders to make adequate disclosure on their returns to avoid liability for this penalty.

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A substantial valuation misstatement exists if the value of any property, or the adjusted basis of any property, claimed on a tax return is 200% or more of the amount determined to be the correct amount of the valuation or adjusted basis. No penalty is imposed unless the portion of the underpayment attributable to a substantial valuation misstatement exceeds \$5,000 (\$10,000 for most corporations). If the valuation claimed on a return is 400% or more than the correct valuation, the penalty imposed increases to 40%.

**State, Local and Other Tax Considerations**

In addition to federal income taxes, you will be subject to other taxes, including state and local income taxes, unincorporated business taxes, and estate, inheritance or intangible taxes that may be imposed by the various jurisdictions in which we do business or own property or in which you are a resident. We currently do business or own property in 26 states, most of which impose income taxes. We may also own property or do business in other states in the future. Although an analysis of those various taxes is not presented here, each prospective unitholder is urged to consider their potential impact on his investment in us. You may not be required to file a return and pay taxes in some states because your income from that state falls below the filing and payment requirement. You will be required, however, to file state income tax returns and to pay state income taxes in many of the states in which we do business or own property, and you may be subject to penalties for failure to comply with those requirements. In some states, tax losses may not produce a tax benefit in the year incurred and also may not be available to offset income in subsequent taxable years. Some of the states may require us, or we may elect, to withhold a percentage of income from amounts to be distributed to a unitholder who is not a resident of the state. Withholding, the amount of which may be greater or less than a particular unitholder's income tax liability to the state, generally does not relieve a 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. Please read "Tax Consequences of Unit Ownership" Entity-Level Collections. Based on current law and our estimate of our future operations, the general partner anticipates that any amounts required to be withheld will not be material.

It is the responsibility of each unitholder to investigate the legal and tax consequences, under the laws of pertinent states and localities, of his investment in us. Accordingly, we strongly recommend that each prospective unitholder consult, and depend upon, his own tax counsel or other advisor with regard to those matters. Further, it is the responsibility of each unitholder to file all state and local, as well as United States federal tax returns, that may be required of him. Vinson & Elkins L.L.P. has not rendered an opinion on the state or local tax consequences of an investment in us.

**SELLING UNITHOLDER**

This prospectus covers the offering for resale of up to 14,590,312 common units by the selling unitholder named below, which include 7,830,924 common units that are issuable upon the conversion of Class B common units and 5,679,694 common units that are issuable upon the conversion of subordinated units. The following table sets forth information relating to the selling unitholder's beneficial ownership of our common units, Class B common units that are convertible into common units and subordinated units that are convertible into common units.

|                             | <b>Number of<br/>Common<br/>Units Owned</b> | <b>Number of<br/>Class B Common<br/>Units Owned</b> | <b>Number of<br/>Subordinated<br/>Units Owned</b> |
|-----------------------------|---|---|---|
| Magellan Midstream Holdings | 1,079,694                                   | 7,830,924   | 5,679,694   |
| <b>TOTAL</b>                | <b>1,079,694</b>                            | <b>7,830,924</b>                                    | <b>5,679,694</b>                                  |



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The applicable prospectus supplement will set forth, with respect to the selling unitholder:

the name of the selling unitholder;

the nature of the position, office or other material relationship which the selling unitholder will have had within the prior three years with us or any of our affiliates;

the number of common units, Class B common units and subordinated units owned by the selling unitholder prior to the offering;

the number of common units, Class B common units and subordinated units to be offered for the selling unitholder's account; and

the amount and (if one percent or more) the percentage of common units, Class B common units and subordinated units to be owned by the selling unitholder after the completion of the offering.

All expenses incurred, excluding underwriting discounts and commission, with the registration of the common units, Class B common units and subordinated units owned by the selling unitholder will be borne by us.

**PLAN OF DISTRIBUTION**

Under this prospectus, the selling unitholder intends to offer our securities to the public:

through one or more broker-dealers;

through underwriters; or

directly to investors.

The selling unitholder will fix a price or prices, and may change the price of the securities offered from time to time:

at market prices prevailing at the time of any sale under this registration statement;

prices related to market prices; or

negotiated prices.



The selling unitholder will pay or allow distributors or sellers commissions that will not exceed those customary in the types of transactions involved. Broker-dealers may act as agents or may purchase securities as principals and thereafter resell the securities from time to time:

in or through one or more transactions (which may involve crosses and block transactions) or distributions;

on the New York Stock Exchange;

in the over-the-counter market; or

in private transactions.

Broker-dealers or underwriters may receive compensation in the form of underwriting discounts or commissions and may receive commissions from purchasers of the securities for whom they may act as agents. If any broker-dealer purchases the securities as a principal, it may effect resales of the securities from time to time to

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or through other broker-dealers, and other broker-dealers may receive compensation in the form of concessions or commissions from the purchasers of securities for whom they may act as agents.

To the extent required, the names of the specific managing underwriter or underwriters, if any, as well as other important information, will be set forth in the applicable prospectus supplement. In that event, the discounts and commissions the selling unitholder will allow or pay to the underwriters, if any, and the discounts and commissions the underwriters may allow or pay to dealers or agents, if any, will be set forth in, or may be calculated from, the prospectus supplements. Any underwriters, brokers, dealers and agents who participate in any sale of the securities may also engage in transactions with, or perform services for, us or our affiliates in the ordinary course of their businesses.

In addition, the selling unitholder has advised us that it may sell common units in compliance with Rule 144, if available, or pursuant to other available exemptions from the registration requirements under the Securities Act, rather than pursuant to this prospectus.

To the extent required, this prospectus may be amended or supplemented from time to time to describe a specific plan of distribution.

In connection with offerings under this shelf registration and in compliance with applicable law, underwriters, brokers or dealers may engage in transactions that stabilize or maintain the market price of the securities at levels above those that might otherwise prevail in the open market. Specifically, underwriters, brokers or dealers may over-allot in connection with offerings, creating a short position in the securities for their own accounts. For the purpose of covering a syndicate short position or stabilizing the price of the securities, the underwriters, brokers or dealers may place bids for the securities or effect purchases of the securities in the open market. Finally, the underwriters may impose a penalty whereby selling concessions allowed to syndicate members or other brokers or dealers for distribution of the securities in offerings may be reclaimed by the syndicate if the syndicate repurchases previously distributed securities in transactions to cover short positions, in stabilization transactions or otherwise. These activities may stabilize, maintain or otherwise affect the market price of the securities, which may be higher than the price that might otherwise prevail in the open market, and, if commenced, may be discontinued at any time.

## **WHERE YOU CAN FIND MORE INFORMATION**

Magellan Midstream Partners files annual, quarterly and special reports and other information with the SEC, under the Securities Exchange Act of 1934. You may read and copy any document we file at the SEC's public reference room at 450 Fifth Street, N.W., Judiciary Plaza Room 1024, Washington, D.C. 20549.

Our common units are listed on the New York Stock Exchange and you may inspect and copy our SEC filings, the complete registration statement and other information at the offices of the New York Stock Exchange located at 20 Broad Street, 16th Floor, New York, New York 10005.

You may obtain information on the operation of the public reference room in Washington, D.C. by calling the SEC at 1-800-732-0330.

## Edgar Filing: MAGELLAN MIDSTREAM PARTNERS LP - Form 424B3

We file information electronically with the SEC. Our SEC filings also are available from the SEC's Internet site at <http://www.sec.gov>, which contains reports and other information regarding issuers that file electronically.

The SEC allows us to incorporate by reference information we file with it into this prospectus. This procedure means that we can disclose important information to you by referring you to documents on file or to be filed with the SEC. The information we incorporate by reference is part of this prospectus and later information that we file with the SEC will automatically update and supersede this information. Therefore, before you decide to invest in a particular offering under this shelf registration, you should always check for SEC reports we may have filed after the date of this prospectus. We incorporate by reference the documents listed below and any future filings made by

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Magellan Midstream Partners with the SEC under Section 13(a), 13(c), 14 or 15(d) of the Securities Exchange Act of 1934 until all offerings under this shelf registration are completed:

Annual Report on Form 10-K for the year ended December 31, 2002;

Quarterly Reports on Form 10-Q for the quarters ended March 31, 2003 and June 30, 2003;

Current Report on Form 8-K filed with the SEC on April 21, 2003 (excluding Item 9 information), June 17, 2003 (excluding Item 9 information), August 8, 2003 (excluding Item 9 information), August 12, 2003 and October 14, 2003; and

The description of the limited partnership units contained in the Registration Statement on Form 8-A, initially filed with the SEC on February 2, 2001, and any subsequent amendment thereto filed for the purposes of updating such description.

You may request a copy of these filings at no cost, by making written or telephone requests for copies to:

Magellan Midstream Partners, L.P.

One Williams Center

P. O. Box 22186

Tulsa, Oklahoma 74121-2186

Attention: Lonny Townsend

(877) 934-6571

**LEGAL MATTERS**

Vinson & Elkins L.L.P. will pass upon the validity of the securities offered in this registration statement.

**EXPERTS**

The consolidated financial statements of Magellan Midstream Partners, L.P. (formerly Williams Energy Partners L.P.) as of December 31, 2002 and 2001 and for each of the years ended December 31, 2002, 2001 and 2000 and the consolidated balance sheets of Magellan GP LLC (formerly WEG GP LLC) as of December 31, 2002 and 2001 appearing in Magellan Midstream Partners, L.P.'s (formerly Williams Energy Partners L.P.) Annual Report (Form 10-K) for the year ended December 31, 2002 have been audited by Ernst & Young LLP, independent auditors, as set forth in their report thereon included therein and incorporated herein by reference. Such consolidated financial statements are

incorporated herein by reference in reliance upon such reports given on the authority of such firm as experts in accounting and auditing.

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