

HOLLY ENERGY PARTNERS LP

Form 10-Q

October 30, 2009

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q**

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2009

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES ACT OF 1934

For the transition period from _____ to _____.

**Commission File Number: 1-32225
HOLLY ENERGY PARTNERS, L.P.**

(Exact name of registrant as specified in its charter)

Delaware

20-0833098

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

100 Crescent Court, Suite 1600
Dallas, Texas 75201-6915

(Address of principal executive offices)

(214) 871-3555

(Registrant's telephone number, including area code)

None

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act).

Yes No

The number of the registrant's outstanding common units at October 23, 2009 was 17,582,400.

HOLLY ENERGY PARTNERS, L.P.
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PART I. FINANCIAL INFORMATION

FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains certain forward-looking statements within the meaning of the federal securities laws. All statements, other than statements of historical fact included in this Form 10-Q, including, but not limited to, those under Results of Operations and Liquidity and Capital Resources in Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations in Part I are forward-looking statements. These statements are based on management's beliefs and assumptions using currently available information and expectations as of the date hereof, are not guarantees of future performance, and involve certain risks and uncertainties. Although we believe that the expectations reflected in these forward-looking statements are reasonable, we cannot assure you that our expectations will prove correct. Therefore, actual outcomes and results could differ materially from what is expressed, implied or forecast in these statements. Any differences could be caused by a number of factors, including, but not limited to:

Risks and uncertainties with respect to the actual quantities of petroleum products and crude oil shipped on our pipelines and/or terminalled in our terminals;

The economic viability of Holly Corporation, Alon USA, Inc. and our other customers;

The demand for refined petroleum products in markets we serve;

Our ability to successfully purchase and integrate additional operations in the future;

Our ability to complete previously announced pending or contemplated acquisitions;

The availability and cost of additional debt and equity financing;

The possibility of reductions in production or shutdowns at refineries utilizing our pipeline and terminal facilities;

The effects of current and future government regulations and policies;

Our operational efficiency in carrying out routine operations and capital construction projects;

The possibility of terrorist attacks and the consequences of any such attacks;

General economic conditions; and

Other financial, operations and legal risks and uncertainties detailed from time to time in our Securities and Exchange Commission filings.

Cautionary statements identifying important factors that could cause actual results to differ materially from our expectations are set forth in this Form 10-Q, including without limitation, the forward-looking statements that are referred to above. When considering forward-looking statements, you should keep in mind the risk factors and other cautionary statements set forth in our Annual Report on Form 10-K for the year ended December 31, 2008 in Risk Factors and in this Form 10-Q in Management's Discussion and Analysis of Financial Condition and Results of Operations. All forward-looking statements included in this Form 10-Q and all subsequent written or oral forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by these cautionary statements. The forward-looking statements speak only as of the date made and, other than as required by law, we undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Table of Contents**Item 1. Financial Statements****Holly Energy Partners, L.P.
Consolidated Balance Sheets**

	September 30, 2009 (Unaudited)	December 31, 2008
	(In thousands, except unit data)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 4,050	\$ 5,269
Accounts receivable:		
Trade	4,965	5,082
Affiliates	11,176	9,395
	16,141	14,477
Prepaid and other current assets	1,070	593
Total current assets	21,261	20,339
Properties and equipment, net	349,062	290,284
Transportation agreements, net	117,173	122,383
Investment in SLC Pipeline	26,809	
Other assets	4,660	6,682
Total assets	\$ 518,965	\$ 439,688
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable:		
Trade	\$ 3,001	\$ 5,816
Affiliates	1,965	2,202
	4,966	8,018
Accrued interest	916	2,845
Deferred revenue	7,582	15,658
Accrued property taxes	1,486	1,145
Other current liabilities	1,368	1,505
Short-term borrowings under credit agreement		29,000
Total current liabilities	16,318	58,171
Long-term debt	429,819	355,793
Other long-term liabilities	13,759	17,604

Equity:**Holly Energy Partners, L.P. partners equity (deficit):**

Common unitholders (17,582,400 and 8,390,000 units issued and outstanding at September 30, 2009 and December 31, 2008, respectively)	136,746	169,126
Subordinated unitholders (7,000,000 units issued and outstanding at December 31, 2008)		(85,059)
Class B subordinated unitholders (937,500 units issued and outstanding at September 30, 2009 and December 31, 2008)	21,054	21,455
General partner interest (2% interest)	(99,359)	(94,653)
Accumulated other comprehensive loss	(10,181)	(12,967)
Total Holly Energy Partners, L.P. partners equity (deficit)	48,260	(2,098)
Noncontrolling interest	10,809	10,218
Total equity	59,069	8,120
Total liabilities and equity	\$ 518,965	\$ 439,688

See accompanying notes.

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Holly Energy Partners, L.P.
Consolidated Statements of Income
(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2009	2008	2009	2008
	(In thousands, except per unit data)			
Revenues:				
Affiliates	\$ 28,359	\$ 22,737	\$ 71,746	\$ 61,210
Third parties	14,385	6,774	43,724	22,352
	42,744	29,511	115,470	83,562
Operating costs and expenses:				
Operations	11,450	11,033	33,332	30,745
Depreciation and amortization	6,820	5,884	19,929	16,259
General and administrative	1,848	1,596	4,990	4,241
	20,118	18,513	58,251	51,245
Operating income	22,626	10,998	57,219	32,317
Other income (expense):				
Equity in earnings of SLC Pipeline	711		1,309	
SLC Pipeline acquisition costs			(2,500)	
Interest income	2	25	10	146
Interest expense	(6,418)	(5,161)	(16,225)	(14,201)
Other		1,007	65	1,043
	(5,705)	(4,129)	(17,341)	(13,012)
Income before income taxes	16,921	6,869	39,878	19,305
State income tax	(113)	(84)	(317)	(237)
Net income	16,808	6,785	39,561	19,068
Less noncontrolling interest in net income	269	164	1,191	834
Net income attributable to Holly Energy Partners, L.P.	\$ 16,539	\$ 6,621	\$ 38,370	\$ 18,234

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Less general partner interest in net income attributable to Holly Energy Partners, L.P.	2,022	1,008	5,163	2,736
Limited partners interest in net income attributable to Holly Energy Partners, L.P.	\$ 14,517	\$ 5,613	\$ 33,207	\$ 15,498
Limited partners per unit interest in net income attributable to Holly Energy Partners, L.P. basic and diluted	\$ 0.78	\$ 0.34	\$ 1.89	\$ 0.95
Weighted average limited partners units outstanding	18,520	16,328	17,546	16,279

See accompanying notes.

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Holly Energy Partners, L.P.
Consolidated Statements of Cash Flows
(Unaudited)

	Nine Months Ended	
	September 30,	
	2009	2008
	(In thousands)	
Cash flows from operating activities		
Net income	\$ 39,561	\$ 19,068
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	19,929	16,259
Equity in earnings of SLC Pipeline	(1,309)	
Change in fair value interest rate swaps	300	
Amortization of restricted and performance units	631	1,194
Gain on sale of assets		(36)
(Increase) decrease in current assets:		
Accounts receivable trade	117	(892)
Accounts receivable affiliates	(1,781)	(3,388)
Prepaid and other current assets	(477)	(312)
Increase (decrease) in current liabilities:		
Accounts payable trade	(2,815)	(52)
Accounts payable affiliates	(237)	(3,684)
Accrued interest	(1,929)	(1,985)
Deferred revenue	(8,076)	10,638
Accrued property taxes	341	200
Other current liabilities	(137)	278
Other, net	670	802
Net cash provided by operating activities	44,788	38,090
Cash flows from investing activities		
Additions to properties and equipment	(27,478)	(29,024)
Acquisition of 16-inch intermediate pipeline	(34,200)	
Investment in SLC Pipeline	(25,500)	
Acquisition of Tulsa loading racks	(11,800)	
Acquisition of crude pipelines and tankage assets		(171,000)
Proceeds from sale of assets		36
Net cash used for investing activities	(98,978)	(199,988)
Cash flows from financing activities		
Borrowings under credit agreement	197,000	221,000
Repayments under credit agreement	(152,000)	(26,000)
Proceeds from issuance of common units	58,355	104
Capital contribution from general partner	1,191	186
Distributions to HEP unitholders	(44,393)	(38,908)
Purchase price in excess of transferred basis in Tulsa loading racks	(5,700)	
Distributions to noncontrolling interest	(600)	(1,200)

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Cost of issuing common units	(266)	
Purchase of units for restricted grants	(616)	(795)
Deferred financing costs		(692)
Net cash provided by financing activities	52,971	153,695
Cash and cash equivalents		
Decrease for period	(1,219)	(8,203)
Beginning of period	5,269	10,321
End of period	\$ 4,050	\$ 2,118

See accompanying notes.

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Holly Energy Partners, L.P.
Consolidated Statement of Equity
(Unaudited)

	Holly Energy Partners, L.P. Partners Equity (Deficit):						Total
	Common Units	Subordinated Units	Class B Subordinated Units	General Partner Interest	Accumulated Other Comprehensive Loss	Non- Controlling Interest	
	(In thousands)						
Balance December 31, 2008	\$ 169,126	\$ (85,059)	\$ 21,455	\$ (94,653)	\$ (12,967)	\$ 10,218	\$ 8,120
Issuance of common units in public offering	58,355						58,355
Conversion of subordinated units	(90,824)	90,824					
Cost of issuing common units	(266)						(266)
Capital contribution				1,191			1,191
Distributions HEP unitholders	(21,253)	(16,275)	(2,180)	(4,685)			(44,393)
Distributions noncontrolling interest						(600)	(600)
Purchase price in excess of transferred basis in Tulsa loading racks				(5,700)			(5,700)
Purchase of units for restricted grants	(616)						(616)
Amortization of restricted and performance units	631						631
Comprehensive income:							
Net income	21,593	10,510	1,779	4,488		1,191	39,561
Change in fair value of cash flow hedge					2,786		2,786
Comprehensive income	21,593	10,510	1,779	4,488	2,786	1,191	42,347
Balance September 30, 2009	\$ 136,746	\$	\$ 21,054	\$ (99,359)	\$ (10,181)	\$ 10,809	\$ 59,069

See accompanying notes.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)**

Note 1: Description of Business and Presentation of Financial Statements

Holly Energy Partners, L.P. (HEP) together with its consolidated subsidiaries, is a publicly held master limited partnership, currently 41% owned by Holly Corporation and its subsidiaries (collectively Holly). We commenced operations July 13, 2004 upon the completion of our initial public offering. In this document, the words we, our, ours and us refer to HEP unless the context otherwise indicates.

We operate in one business segment the operation of petroleum product and crude oil pipelines and terminals, tankage and loading rack facilities.

One of Holly s wholly-owned subsidiaries owns a refinery in Artesia, New Mexico, which Holly operates in conjunction with crude, vacuum distillation and other facilities situated in Lovington, New Mexico (collectively, the Navajo Refinery). The Navajo Refinery produces high-value refined products such as gasoline, diesel fuel and jet fuel and serves markets in the southwestern United States and northern Mexico. We own and operate intermediate feedstock pipelines (the Intermediate Pipelines), which connect the New Mexico refining facilities. Our operations serving the Navajo Refinery include refined product pipelines that serve as part of the refinery s product distribution network. We also own and operate crude oil pipelines and on-site crude oil tankage that supply and support the refinery. Our terminal operations serving the Navajo Refinery include an on-site truck rack at the refinery and five integrated refined product terminals located in New Mexico, Texas and Arizona.

Another of Holly s wholly-owned subsidiaries owns a refinery located near Salt Lake City, Utah (the Woods Cross Refinery). Our operations serving the Woods Cross Refinery include crude oil and refined product pipelines, crude oil tankage and a truck rack at the refinery, a refined product terminal in Spokane, Washington and a 50% non-operating interest in product terminals in Boise and Burley, Idaho.

In June 2009, Holly acquired a petroleum refinery, including supporting infrastructure, located in Tulsa, Oklahoma (the Tulsa Refinery). On August 1, 2009, we acquired from Holly certain on-site truck and rail loading/unloading facilities that service the Tulsa Refinery. See Note 2 for additional information on this transaction.

We also own and operate refined products pipelines and terminals, located primarily in Texas, that service Alon USA, Inc. s (Alon) refinery in Big Spring, Texas.

Additionally, we own a refined product terminal in Mountain Home, Idaho, and a 70% interest in Rio Grande Pipeline Company (Rio Grande), which provides transportation of liquefied petroleum gases to northern Mexico.

In March 2009, we acquired a 25% joint venture interest in a new 95-mile intrastate pipeline system (the SLC Pipeline) jointly owned by Plains All American Pipeline, L.P. (Plains) and us. See Note 2 for additional information on the SLC Pipeline joint venture.

The consolidated financial statements included herein have been prepared without audit, pursuant to the rules and regulations of the United States Securities and Exchange Commission (the SEC). The interim financial statements reflect all adjustments, which, in the opinion of management, are necessary for a fair presentation of our results for the interim periods. Such adjustments are considered to be of a normal recurring nature. Although certain notes and other information required by accounting principles generally accepted in the United States of America have been condensed or omitted, we believe that the disclosures in these consolidated financial statements are adequate to make the information presented not misleading. These consolidated financial statements should be read in conjunction with our Form 10-K for the year ended December 31, 2008. Results of operations for interim periods are not necessarily indicative of the results of operations that will be realized for the year ending December 31, 2009.

These consolidated financial statements reflect management s evaluation of subsequent events through the time of our filing of this quarterly report on October 30, 2009.

Table of Contents**Recent Accounting Pronouncements***Accounting Standards Codification*

In June 2009, the Financial Accounting Standards Board (FASB) issued its Accounting Standards Codification (ASC), codifying all previous sources of accounting principles into a single source of authoritative, nongovernmental U.S. generally accepted accounting principles (U.S. GAAP). Although the ASC supersedes all previous levels of authoritative accounting standards, it did not affect accounting principles under U.S. GAAP. We adopted the codification effective September 30, 2009.

Subsequent Events

In May 2009, the FASB issued accounting standards under ASC Topic Subsequent Events (previously Statement of Financial Accounting Standard (SFAS) No. 165) which establish general standards for accounting and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. We adopted these standards effective June 30, 2009. Although these standards require disclosure of the date through which we have evaluated subsequent events, it did not affect our accounting and disclosure policies with respect to subsequent events.

Interim Disclosures about Fair Value of Financial Instruments

In April 2009, the FASB issued accounting standards under ASC Topic Financial Instruments (previously FASB Staff Position (FSP) SFAS No. 107-1 and Accounting Principles Board (APB) Opinion No. 28-1) which extend the annual financial statement disclosure requirements for financial instruments to interim reporting periods of publicly traded companies. We adopted these standards effective June 30, 2009. See Note 3 for disclosure of our financial instruments.

Noncontrolling Interests in Consolidated Financial Statements

Accounting standards under ASC Topic Noncontrolling Interest in a Subsidiary (previously SFAS No. 160) became effective January 1, 2009, which change the classification of noncontrolling interests, also referred to as minority interests, in the consolidated financial statements. As a result, all previous references to minority interest within this document have been replaced with noncontrolling interest. Additionally, net income attributable to the noncontrolling interest in our Rio Grande subsidiary is now presented as an adjustment to net income to arrive at Net income attributable to Holly Energy Partners, L.P. in our Consolidated Statements of Income. Prior to our adoption of these standards, this amount was presented as Minority interest in Rio Grande, a non-operating expense item before Income before income taxes. Furthermore, equity attributable to noncontrolling interests in our Rio Grande subsidiary is now presented as a separate component of total equity in our Consolidated Financial Statements. We have applied these standards on a retrospective basis. While this presentation differs from previous U.S. GAAP requirements, it did not affect our net income and equity attributable to HEP.

Business Combinations

Accounting standards under ASC Topic Business Combinations (previously SFAS 141 No. (R)) became effective January 1, 2009, which establish principles and requirements for how an acquirer accounts for a business combination. It also requires that acquisition-related transaction and restructuring costs be expensed rather than be capitalized as part of the cost of an acquired business. Accordingly, we were required to expense the \$2.5 million finder's fee related to the acquisition of our SLC Pipeline joint venture interest.

Disclosures about Derivative Instruments and Hedging Activities

Accounting standards under ASC Topic Derivatives and Hedging (previously SFAS No. 161) became effective January 1, 2009, which amend and expand disclosure requirements to include disclosure of the objectives and strategies related to an entity's use of derivative instruments, disclosure of how an entity accounts for its derivative instruments and disclosure of the financial impact, including the effect on cash flows associated with derivative activity. See Note 7 for disclosure of our derivative instruments and hedging activity.

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Accounting standards under ASC Topic Earnings Per Share (previously Emerging Issues Task Force (EITF) Issue No. 07-04) became effective January 1, 2009, which prescribe the application of the two-class method in computing earnings per unit to reflect a master limited partnership's contractual obligation to make distributions to the general partner, limited partners and incentive distribution rights holders. As a result, quarterly earnings allocations to the general partner now include incentive distributions that were declared subsequent to quarter end. Prior to our adoption of these standards, our general partner earnings allocations included incentive distributions that were declared during each quarter. We have applied these standards on a retrospective basis. The adoption of these standards resulted in a decrease in our limited partners' interest in net income attributable to Holly Energy Partners, L.P. for the three and nine months ended September 30, 2008, reducing earnings per limited partner unit by \$.01 to \$0.34 and \$0.95 for the three and nine months ended September 30, 2008, respectively.

Participating Securities – Instruments Granted in Share-Based Transactions

Accounting standards under ASC Topic Earnings Per Share (previously FSP No. 03-6-1) became effective January 1, 2009, which provide guidance in determining whether unvested instruments granted under share-based payment transactions are participating securities and, therefore, should be included in earnings per share calculations under the two-class method. The adoption of these standards did not have a material impact on our financial condition, results of operations and cash flows.

Note 2: Acquisitions*Tulsa Loading Racks Transaction*

On August 1, 2009, we acquired from Holly certain truck and rail loading/unloading facilities located at Holly's Tulsa Refinery (the Tulsa Loading Racks) for \$17.5 million. The racks load refined products produced at the Tulsa Refinery onto rail cars and/or tanker trucks for delivery to surrounding markets. In accounting for this transaction, we recorded property and equipment of \$11.8 million representing Holly's cost basis in the transferred assets since we are a controlled subsidiary of Holly and recorded the remaining \$5.7 million as a decrease to our partners' equity. In connection with this transaction, we entered into a 15-year equipment and throughput agreement with Holly (the Holly ETA), whereby Holly has agreed to throughput a minimum volume of products via the Tulsa Loading Racks that will initially result in minimum annual revenues to us of \$2.7 million.

Lovington-Artesia Pipeline Transaction

On June 1, 2009, we acquired a newly constructed 16-inch intermediate pipeline from Holly for \$34.2 million. The pipeline runs 65 miles from the Navajo Refinery's crude oil distillation and vacuum facilities in Lovington, New Mexico to its petroleum refinery located in Artesia, New Mexico. This pipeline was placed in service effective June 1, 2009 and operates as a component of our Intermediate Pipeline system that services Holly's Navajo Refinery. In connection with this transaction, Holly agreed to amend our transportation agreement that relates to the Intermediate Pipelines acquired in 2005 (the Holly IPA). As a result, the term of the Holly IPA was extended by an additional 4 years and now expires in June 2024. Additionally, Holly's minimum commitment under the Holly IPA was increased and the Holly IPA now results in minimum annual payments to us of \$20.7 million.

SLC Pipeline Joint Venture Interest

On March 1, 2009, we acquired a 25% joint venture interest in the SLC Pipeline, a new 95-mile intrastate pipeline system jointly owned by Plains and us. The SLC Pipeline commenced operations effective March 2009 and allows various refiners in the Salt Lake City area, including Holly's Woods Cross Refinery, to ship crude oil into the Salt Lake City area from the Utah terminus of the Frontier Pipeline as well as crude oil flowing from Wyoming and Utah via Plains' Rocky Mountain Pipeline. The total cost of our investment in the SLC Pipeline was \$28.0 million, consisting of the capitalized \$25.5 million joint venture contribution and the \$2.5 million finder's fee paid to Holly that was expensed as acquisition costs.

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We account for our investment using the equity method of accounting. Under the equity method of accounting, we record our pro-rata share of earnings of the SLC Pipeline, and contributions to and distributions from the SLC Pipeline as adjustments to our investment balance.

Crude Pipelines and Tankage Transaction

On February 29, 2008, we acquired crude pipeline and tankage assets from Holly (the *Crude Pipelines and Tankage Assets*) for \$180.0 million that consist of crude oil trunk lines that deliver crude oil to Holly's Navajo Refinery in southeast New Mexico, gathering and connection pipelines located in west Texas and New Mexico, on-site crude tankage located within the Navajo and Woods Cross Refinery complexes, a jet fuel products pipeline between Artesia and Roswell, New Mexico, a leased jet fuel terminal in Roswell, New Mexico and crude oil and product pipelines that support Holly's Woods Cross Refinery. The consideration paid consisted of \$171.0 million in cash and 217,497 of our common units having a fair value of \$9.0 million. We financed the \$171.0 million cash portion of the consideration through borrowings under our senior secured revolving credit agreement expiring August 2011.

In connection with this transaction, we entered into a 15-year crude pipelines and tankage agreement with Holly (the *Holly CPTA*). Under the *Holly CPTA*, Holly agreed to transport and store volumes of crude oil on the crude pipelines and tankage facilities that result in minimum annual payments to us. These minimum annual payments or revenues will be adjusted each year at a rate based upon the percentage change in the Producer Price Index (*PPI*) but will not decrease as a result of a decrease in the *PPI*. Under the agreement, the tariff rates will generally be increased annually by the percentage change in the Federal Energy Regulatory Commission (*FERC*) Oil Pipeline Index. The *FERC* index is the change in the *PPI* plus a *FERC* adjustment factor that is reviewed periodically.

Note 3: Financial Instruments

Our financial instruments consist of cash and cash equivalents, accounts receivable, accounts payable, debt and interest rate swaps. The carrying amounts of cash and cash equivalents, accounts receivable and accounts payable approximate fair value due to the short-term maturity of these instruments.

Our debt consists of outstanding principal under our revolving credit agreement (the *Credit Agreement*) and our 6.25% senior notes (the *Senior Notes*). The \$245.0 million carrying amount of outstanding debt under our *Credit Agreement* approximates fair value as interest rates are reset frequently using current rates. The estimated fair value of our *Senior Notes* was \$169.3 million at September 30, 2009. This fair value estimate is based on market quotes provided from a third-party bank. See Note 7 for additional information on these instruments.

Fair Value Measurements

Fair value measurements are derived using inputs, assumptions that market participants would use in pricing an asset or liability, including assumptions about risk. GAAP categorizes inputs used in fair value measurements into three broad levels as follows:

(Level 1) Quoted prices in active markets for identical assets or liabilities.

(Level 2) Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets, similar assets and liabilities in markets that are not active or can be corroborated by observable market data.

(Level 3) Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. This includes valuation techniques that involve significant unobservable inputs.

We have interest rate swaps that are measured at fair value on a recurring basis using Level 2 inputs. With respect to these instruments, fair value is based on the net present value of expected future cash flows related to both variable and fixed rate legs of our interest rate swap agreements. Our

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measurements are computed using the forward London Interbank Offered Rate (LIBOR) yield curve, a market-based observable input. See Note 7 for additional information on our interest rate swaps, including fair value measurements.

Note 4: Properties and Equipment

	September 30, 2009	December 31, 2008
	(In thousands)	
Pipelines and terminals	\$ 344,084	\$ 308,056
Land and right of way	26,978	24,991
Other	11,882	11,498
Construction in progress	75,088	38,589
	458,032	383,134
Less accumulated depreciation	108,970	92,850
	\$ 349,062	\$ 290,284

We capitalized \$0.9 million and \$0.7 million in interest related to major construction projects during the nine months ended September 30, 2009 and 2008, respectively.

Note 5: Transportation Agreements

Our transportation agreements consist of the following:

The Alon pipelines and terminals agreement (the Alon PTA) represents a portion of the total purchase price of the Alon assets that was allocated based on an estimated fair value derived under an income approach. This asset is being amortized over 30 years ending 2035, the 15-year initial term of the Alon PTA plus the expected 15-year extension period.

The Holly crude pipelines and tankage agreement represents a portion of the total purchase price of the Crude Pipelines and Tankage Assets that was allocated using a fair value based on the agreement's expected contribution to our future earnings under an income approach. This asset is being amortized over 15 years ending 2023, the 15-year term of the Holly CPTA.

The carrying amounts of our transportation agreements are as follows:

	September 30, 2009	December 31, 2008
	(In thousands)	
Alon transportation agreement	\$ 59,933	\$ 59,933
Holly crude pipelines and tankage agreement	74,231	74,231
	134,164	134,164
Less accumulated amortization	16,991	11,781
	\$ 117,173	\$ 122,383

We have three additional transportation agreements with Holly. One of the agreements relates to the pipelines and terminals contributed to us from Holly at the time of our initial public offering in 2004 (the Holly PTA). We also have the Holly IPA that relates to the Intermediate Pipelines acquired from Holly in 2005 and in June 2009 and the Holly ETA that relates to the Tulsa Loading Racks acquired in August 2009. Our basis in the assets acquired under these transfers reflects Holly's historical cost and does not reflect a step-up in basis to fair value. Therefore, these agreements

have a recorded value of zero.

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Table of Contents**Note 6: Employees, Retirement and Incentive Plans**

Employees who provide direct services to us are employed by Holly Logistic Services, L.L.C., a Holly subsidiary. Their costs, including salaries, bonuses, payroll taxes, benefits and other direct costs, are charged to us monthly in accordance with an omnibus agreement that we have with Holly (the Omnibus Agreement). These employees participate in the retirement and benefit plans of Holly. Our share of retirement and benefit plan costs was \$0.8 million and \$0.6 million for the three months ended September 30, 2009 and 2008, respectively, and \$2.0 million and \$1.6 million for the nine months ended September 30, 2009 and 2008, respectively.

We have adopted an incentive plan (Long-Term Incentive Plan) for employees, consultants and non-employee directors who perform services for us. The Long-Term Incentive Plan consists of four components: restricted units, performance units, unit options and unit appreciation rights.

As of September 30, 2009, we have two types of equity-based compensation, which are described below. The compensation cost charged against income for these plans was \$0.2 million and \$0.6 million for the three months ended September 30, 2009 and 2008, respectively, and \$1.1 million and \$1.4 million for the nine months ended September 30, 2009 and 2008, respectively. It is currently our policy to purchase units in the open market instead of issuing new units for settlement of restricted unit grants. At September 30, 2009, 350,000 units were authorized to be granted under the equity-based compensation plans, of which 203,684 had not yet been granted.

Restricted Units

Under our Long-Term Incentive Plan, we grant restricted units to selected employees and directors who perform services for us, with vesting generally over a period of one to five years. Although full ownership of the units does not transfer to the recipients until the units vest, the recipients have distribution and voting rights on these units from the date of grant. The vesting for certain key executives is contingent upon certain earnings per unit targets being realized. The fair value of each restricted unit grant was measured at the market price as of the date of grant and is being amortized over the vesting period, including the units issued to the key executives, as we expect those units to fully vest.

A summary of restricted unit activity and changes during the nine months ended September 30, 2009 is presented below:

Restricted Units	Grants	Weighted-Average Grant-Date Fair Value	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value (\$000)
Outstanding January 1, 2009 (not vested)	53,505	\$ 41.28		
Granted	33,422	26.00		
Forfeited	(2,152)	42.53		
Vesting and transfer of full ownership to recipients	(31,504)	36.76		
Outstanding at September 30, 2009 (not vested)	53,271	\$ 34.31	0.8 year	\$ 2,078

The fair value of restricted units that were vested and transferred to recipients during the nine months ended September 30, 2009 and 2008 were \$1.2 million and \$0.9 million, respectively. As of September 30, 2009, there was \$0.7 million of total unrecognized compensation costs related to nonvested restricted unit grants. That cost is expected to be recognized over a weighted-average period of 0.8 year.

During the nine months ended September 30, 2009, we paid \$0.6 million for the purchase of 26,431 of our common units in the open market for the recipients of our 2009 restricted unit grants.

Table of Contents***Performance Units***

Under our Long-Term Incentive Plan, we grant performance units to selected executives and employees who perform services for us. These performance units are payable based upon the growth in distributions on our common units during the requisite period, and generally vest over a period of three years. As of September 30, 2009, estimated share payouts for outstanding nonvested performance unit awards ranged from 110% to 120%.

We granted 28,113 performance units to certain officers in March 2009. These units will vest over a three-year performance period ending December 31, 2011 and are payable in HEP common units. The number of units actually earned will be based on the growth of distributions to limited partners over the performance period and can range from 50% to 150% of the number of performance units issued. The fair value of these performance units is based on the grant date closing unit price of \$23.30 and will apply to the number of units ultimately awarded.

A summary of performance unit activity and changes during the nine months ended September 30, 2009 is presented below:

Performance Units	Payable In Units
Outstanding at January 1, 2009 (not vested)	36,971
Granted	28,113
Forfeited	
Vesting and transfer of common units to recipients	(10,313)
Outstanding at September 30, 2009 (not vested)	54,771

The fair value of performance units that were vested and transferred to recipients during the nine months ended September 30, 2009 and 2008 were \$0.4 million and \$0.1 million, respectively. Based on the weighted average grant date fair value of \$32.95 at September 30, 2009 there was \$0.9 million of total unrecognized compensation cost related to nonvested performance units. That cost is expected to be recognized over a weighted-average period of 1.3 years.

Note 7: Debt***Credit Agreement***

We have a \$300.0 million senior secured revolving credit agreement expiring in August 2011, the Credit Agreement. The Credit Agreement is available to fund capital expenditures, acquisitions, and working capital and for general partnership purposes. In addition, the Credit Agreement is available to fund letters of credit up to a \$50.0 million sub-limit and to fund distributions to unitholders up to a \$20.0 million sub-limit. Advances under the Credit Agreement that are designated for working capital are classified as short-term liabilities. Other advances under the Credit Agreement, including advances used for the financing of capital projects, are classified as long-term liabilities. During the nine months ended September 30, 2009, we received advances totaling \$197.0 million that were used as interim financing for our acquisitions and for capital projects and repaid \$152.0 million, resulting in \$45.0 million in net advances received. As of September 30, 2009, we had \$245.0 million outstanding under the Credit Agreement. Our obligations under the Credit Agreement are collateralized by substantially all of our assets. Indebtedness under the Credit Agreement is recourse to HEP Logistics Holdings, L.P., our general partner, and guaranteed by our wholly-owned subsidiaries. Any recourse to HEP Logistics Holdings, L.P. would be limited to the extent of its assets, which other than its investment in us, are not significant.

We may prepay all loans at any time without penalty, except for payment of certain breakage and related costs. We are required to reduce all working capital borrowings under the Credit Agreement to zero for a period of at least 15 consecutive days in each twelve-month period prior to the maturity date of the agreement. As of September 30, 2009, we had no working capital borrowings.

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Indebtedness under the Credit Agreement bears interest, at our option, at either (a) the reference rate as announced by the administrative agent plus an applicable margin (ranging from 0.25% to 1.50%) or (b) at a rate equal to LIBOR plus an applicable margin (ranging from 1.00% to 2.50%). In each case, the applicable margin is based upon the ratio of our funded debt (as defined in the agreement) to EBITDA (earnings before interest, taxes, depreciation and amortization, as defined in the agreement). At September 30, 2009, we were subject to an applicable margin of 1.75%. We incur a commitment fee on the unused portion of the Credit Agreement at a rate ranging from 0.20% to 0.50% based upon the ratio of our funded debt to EBITDA for the four most recently completed fiscal quarters. At September 30, 2009, we are subject to a 0.30% commitment fee on the \$55.0 million unused portion of the Credit Agreement. The agreement expires in August 2011. At that time, the agreement will terminate and all outstanding amounts thereunder will become due and payable.

The Credit Agreement imposes certain requirements on us, including: a prohibition against distribution to unitholders if, before or after the distribution, a potential default or an event of default as defined in the agreement would occur; limitations on our ability to incur debt, make loans, acquire other companies, change the nature of our business, enter a merger or consolidation, or sell assets; and covenants that require maintenance of a specified EBITDA to interest expense ratio and debt to EBITDA ratio. If an event of default exists under the agreement, the lenders will be able to accelerate the maturity of the debt and exercise other rights and remedies.

Additionally, the Credit Agreement contains certain provisions whereby the lenders may accelerate payment of outstanding debt under certain circumstances.

Senior Notes Due 2015

Our Senior Notes maturing March 1, 2015 are registered with the SEC and bear interest at 6.25%. The Senior Notes are unsecured and impose certain restrictive covenants, including limitations on our ability to incur additional indebtedness, make investments, sell assets, incur certain liens, pay distributions, enter into transactions with affiliates, and enter into mergers. At any time when the Senior Notes are rated investment grade by both Moody's and Standard & Poor's and no default or event of default exists, we will not be subject to many of the foregoing covenants. Additionally, we have certain redemption rights under the Senior Notes.

Indebtedness under the Senior Notes is recourse to HEP Logistics Holdings, L.P., our general partner, and guaranteed by our wholly-owned subsidiaries. Any recourse to HEP Logistics Holdings, L.P. would be limited to the extent of its assets, which other than its investment in us, are not significant.

The carrying amounts of our long-term debt are as follows:

	September 30, 2009	December 31, 2008
	(In thousands)	
Credit Agreement	\$ 245,000	\$ 200,000
Senior Notes		
Principal	185,000	185,000
Unamortized discount	(2,058)	(2,344)
Unamortized premium dedesignated fair value hedge	1,877	2,137
	184,819	184,793
Total debt	429,819	384,793
Less net short-term borrowings under credit agreement ⁽¹⁾		29,000
Total long-term debt ⁽¹⁾	\$ 429,819	\$ 355,793

- (1) We currently classify all borrowings under the Credit Agreement as long-term. At December 31, 2008, we classified certain of our Credit Agreement borrowings as short-term.

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Table of Contents***Interest Rate Risk Management***

We use interest rate derivatives to manage our exposure to interest rate risk. As of September 30, 2009, we have three interest rate swap contracts.

We have an interest rate swap that hedges our exposure to the cash flow risk caused by the effects of LIBOR changes on the \$171.0 million Credit Agreement advance that we used to finance our purchase of the Crude Pipelines and Tankage Assets in February 2008. This interest rate swap effectively converts our \$171.0 million LIBOR based debt to fixed rate debt having an interest rate of 3.74% plus an applicable margin, currently 1.75%, which equaled an effective interest rate of 5.49% as of September 30, 2009. The maturity date of this swap contract is February 28, 2013.

We have designated this interest rate swap as a cash flow hedge. Based on our assessment of effectiveness using the change in variable cash flows method, we have determined that this interest rate swap is effective in offsetting the variability in interest payments on our \$171.0 million variable rate debt resulting from changes in LIBOR. Under hedge accounting, we adjust our cash flow hedge on a quarterly basis to its fair value with the offsetting fair value adjustment to accumulated other comprehensive income. Also on a quarterly basis, we measure hedge effectiveness by comparing the present value of the cumulative change in the expected future interest to be paid or received on the variable leg of our swap against the expected future interest payments on our \$171.0 million variable rate debt. Any ineffectiveness is reclassified from accumulated other comprehensive income to interest expense. As of September 30, 2009, we had no ineffectiveness on our cash flow hedge.

We also have an interest rate swap contract that effectively converts interest expense associated with \$60.0 million of our 6.25% Senior Notes from a fixed to a variable rate (Variable Rate Swap). Under this swap contract, interest on the \$60.0 million notional amount is computed using the three-month LIBOR plus a spread of 1.1575%, which equaled an effective interest rate of 1.52% as of September 30, 2009. The maturity date of this swap contract is March 1, 2015, matching the maturity of the Senior Notes.

In October 2008, we entered into an additional interest rate swap contract, effective December 1, 2008, that effectively unwinds the effects of the Variable Rate Swap discussed above, converting \$60.0 million of our hedged long-term debt back to fixed rate debt (Fixed Rate Swap). Under the Fixed Rate Swap, interest on a notional amount of \$60.0 million is computed at a fixed rate of 3.59% versus three-month LIBOR which when added to the 1.1575% spread on the Variable Rate Swap results in an effective fixed interest rate of 4.75%. The maturity date of this swap contract is December 1, 2013.

Prior to the execution of our Fixed Rate Swap, the Variable Rate Swap was designated as a fair value hedge of \$60.0 million in outstanding principal under the Senior Notes. We dedesignated this hedge in October 2008. At this time, the carrying balance of our Senior Notes included a \$2.2 million premium due to the application of hedge accounting until the dedesignation date. This premium is being amortized as a reduction to interest expense over the remaining term of the Variable Rate Swap.

Our interest rate swaps not having a hedge designation are measured quarterly at fair value either as an asset or a liability in our consolidated balance sheets with the offsetting fair value adjustment to interest expense. For the three and nine months ended September 30, 2009, we recognized an increase of \$0.9 million and \$0.3 million, respectively, in interest expense as a result of fair value adjustments to our interest rate swaps.

We record interest expense equal to the variable rate payments under the swaps. Receipts under the swap agreements are recorded as a reduction of interest expense.

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Additional information on our interest rate swaps as of September 30, 2009 is as follows:

Interest Rate Swaps	Balance Sheet Location	Fair Value (In thousands)	Location of Offsetting Balance	Offsetting Amount
Asset				
Fixed-to-variable interest rate swap - \$60 million of 6.25% Senior Notes	Other assets	\$ 2,658	Long-term debt HEP partners equity Interest expense	\$ (1,877) (1,942) ⁽¹⁾ 1,161 ⁽²⁾
		\$ 2,658		\$ (2,658)
Liability				
Cash flow hedge \$171 million LIBOR based debt	Other long-term liabilities	\$ (10,182)	Accumulated other comprehensive loss	\$ 10,182
Variable-to-fixed interest rate swap - \$60 million	Other long-term liabilities	(3,044)	HEP partners equity Interest expense	4,166 ⁽¹⁾ (1,122)
		\$ (13,226)		\$ 13,226

(1) Represents prior year charges to interest expense.

(2) Net of amortization of premium attributable to dedesignated hedge.

Interest Expense and Other Debt Information

Interest expense consists of the following components:

**Nine Months Ended
September 30,
2009 2008**
(In thousands)

Interest on outstanding debt:

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Senior Notes, net of interest rate swaps	\$ 8,320	\$ 7,901
Credit Agreement, net of interest rate swap	8,045	6,013
Net amortization of discount and deferred debt issuance costs	529	739
Commitment fees	202	241
Total interest incurred	17,096	14,894
Less capitalized interest	871	693
Net interest expense	\$ 16,225	\$ 14,201
Cash paid for interest ⁽¹⁾	\$ 18,307	\$ 11,414

(1) Net of cash received under our interest rate swap agreements of \$3.8 million for the nine months ended September 30, 2009 and 2008.

Note 8: Significant Customers

All revenues are domestic revenues, of which over 90% are currently generated from our three largest customers: Holly, Alon and BP Plc (BP). The major concentration of our pipeline system revenues are derived from activities conducted in the southwest United States. The following table presents the percentage of total revenues generated by each of these three customers:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Holly	66%	77%	62%	73%
Alon	24%	13%	27%	15%
BP	3%	6%	5%	8%

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Table of Contents**Note 9: Related Party Transactions*****Holly and Alon Agreements***

As of September 30, 2009, we serve Holly's refineries in New Mexico, Utah and Oklahoma under multiple long-term pipeline and terminal, tankage and throughput agreements. The substantial majority of our business is devoted to providing transportation, storage and terminalling services to Holly.

In connection with our August 2009 acquisition of the Tulsa Loading Racks from Holly, we entered into the Holly ETA, a 15-year equipment and throughput agreement that expires in 2024. Under this agreement, Holly has agreed to throughput a minimum volume of products via the Tulsa Loading Racks that will initially result in minimum annual revenues to us of \$2.7 million.

We have three additional agreements that also relate to assets acquired from Holly. We have the Holly PTA (expiring in 2019) that relates to the pipelines and terminals contributed to us at the time of our initial public offering in 2004, the Holly IPA (expiring in 2024) that relates to the Intermediate Pipelines acquired in 2005 and in June 2009, and the Holly CPTA (expiring in 2023) that relates to the Crude Pipelines and Tankage Assets acquired in 2008.

Under the Holly PTA, Holly IPA, Holly CPTA and Holly ETA, Holly agreed to transport, store and throughput volumes of refined product and crude oil on our pipelines and terminals, tankage and loading rack facilities that result in minimum annual payments to us. These minimum annual payments or revenues will be adjusted each year at a percentage change based upon the change in the PPI but will not decrease as a result of a decrease in the PPI. Under these agreements, the agreed upon tariff rates are adjusted each year on July 1 at a rate based upon the percentage change in the PPI or FERC index, but generally will not decrease as a result of a decrease in the PPI or FERC index. The FERC index is the change in the PPI plus a FERC adjustment factor that is reviewed periodically. Following the July 1, 2009 PPI rate adjustments, these agreements will result in minimum payments to us of \$95.3 million for the twelve months ended June 30, 2010.

We also have a pipelines and terminals agreement with Alon expiring in 2020 under which Alon has agreed to transport on our pipelines and throughput through our terminals volumes of refined products that results in a minimum level of annual revenue. The agreed upon tariffs are increased or decreased annually at a rate equal to the percentage change in the PPI, but not below the initial tariff rate. Following the March 1, 2009 PPI rate adjustment, Alon's total minimum commitment for the twelve months ending February 28, 2010 decreased to \$21.7 million.

If either Holly or Alon fails to meet its minimum volume commitment under the agreements in any quarter, it will be required to pay us in cash the amount of any shortfall by the last day of the month following the end of the quarter. With the exception of the Holly CPTA and the Holly ETA, a shortfall payment may be applied as a credit in the following four quarters after minimum obligations are met.

Under certain provisions of the Omnibus Agreement that we have with Holly, we pay Holly an annual administrative fee, currently \$2.3 million, for the provision by Holly or its affiliates of various general and administrative services to us. This fee does not include the salaries of pipeline and terminal personnel or the cost of their employee benefits, which are separately charged to us by Holly. We also reimburse Holly and its affiliates for direct expenses they incur on our behalf.

Pipeline, terminal and tankage revenues received from Holly were \$28.4 million and \$22.7 million for the three months ended September 30, 2009 and 2008, respectively, and \$71.7 million and \$61.2 million for the nine months ended September 30, 2009 and 2008, respectively. These amounts include the revenues received under the Holly PTA, Holly IPA, Holly CPTA and Holly ETA.

Holly charged general and administrative services under the Omnibus Agreement of \$0.6 million for the three months ended September 30, 2009 and 2008 and \$1.7 million and \$1.6 million for the nine months ended September 30, 2009 and 2008, respectively.

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We reimbursed Holly for costs of employees supporting our operations of \$4.2 million and \$3.7 million for the three months ended September 30, 2009 and 2008, respectively, and \$12.8 million and \$9.8 million for the nine months ended September 30, 2009 and 2008, respectively.

We distributed \$7.6 million and \$6.5 million during the three months ended September 30, 2009 and 2008, respectively, to Holly as regular distributions on its common units, subordinated units and general partner interest, including general partner incentive distributions. We distributed \$21.6 million and \$18.9 million during the nine months ended September 30, 2009 and 2008, respectively.

Our accounts receivable from Holly was \$11.2 million and \$9.4 million at September 30, 2009 and December 31, 2008, respectively.

Holly has failed to meet its minimum volume commitment for each of the seventeen quarters since inception of the Holly IPA. Through September 30, 2009, we have charged Holly \$9.8 million for these shortfalls to date, \$0.6 million and \$0.5 million of which is included in affiliate accounts receivable at September 30, 2009 and December 31, 2008, respectively.

Our revenues for the three and nine months ended September 30, 2009 include \$0.8 million and \$1.9 million, respectively, of shortfalls billed under the Holly IPA in 2008 as Holly did not exceed its minimum volume commitment in any of the subsequent four quarters. Deferred revenue in the consolidated balance sheets at September 30, 2009 and December 31, 2008, includes \$3.3 million and \$2.4 million, respectively, relating to the Holly IPA. It is possible that Holly may not exceed its minimum obligations under the Holly IPA to allow Holly to receive credit for any of the \$3.3 million deferred at September 30, 2009.

We acquired the Tulsa Loading Racks, our 16-inch intermediate pipeline and the Crude Pipelines and Tankage Assets from Holly in August 2009, June 2009 and February 2008, respectively. See Note 2 for a description of these transactions.

We paid Holly a \$2.5 million finder's fee in the first quarter of 2009 in consideration for its assistance in obtaining our joint venture interest in the SLC Pipeline.

Alon became a related party when it acquired all of our Class B subordinated units in connection with our acquisition of assets from it in February 2005.

Pipeline and terminal revenues received from Alon were \$8.8 million and \$1.9 million for the three months ended September 30, 2009 and 2008, respectively, and \$25.8 million and \$6.8 million for the nine months ended September 30, 2009 and 2008, respectively, under the Alon PTA. Additionally, pipeline revenues received under a pipeline capacity lease agreement with Alon were \$1.6 million and \$1.8 million for the three months ended September 30, 2009 and 2008, respectively, and \$5.0 million and \$5.3 million for the nine months ended September 30, 2009 and 2008, respectively.

We distributed \$0.7 million during the three months ended September 30, 2009 and 2008 and \$2.2 million and \$2.1 million during the nine months ended September 30, 2009 and 2008, respectively, to Alon as distributions on its Class B subordinated units.

Our accounts receivable trade include receivable balances from Alon of \$3.2 million and \$2.5 million at September 30, 2009 and December 31, 2008, respectively.

Our revenues for the three and nine months ended September 30, 2009 include \$4.3 million and \$11.9 million, respectively, of shortfalls billed under the Alon PTA in 2008 as Alon did not exceed its minimum revenue obligation in any of the subsequent four quarters. Deferred revenue in the consolidated balance sheets at September 30, 2009 and December 31, 2008 includes \$4.3 million and \$13.3 million, respectively, relating to the Alon PTA. It is possible that Alon may not exceed its minimum obligations under the Alon PTA to allow Alon to receive credit for any of the \$4.3 million deferred at September 30, 2009.

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BP

We have a 70% ownership interest in Rio Grande and BP owns the other 30%. Due to the ownership interest and resulting consolidation, BP is a related party to us.

BP is one of multiple shippers on the Rio Grande pipeline. We recorded revenues from BP of \$1.4 million and \$1.7 million for the three months ended September 30, 2009 and 2008, respectively, and \$5.3 million and \$6.6 million for the nine months ended September 30, 2009 and 2008, respectively.

Our accounts receivable trade at September 30, 2009 and December 31, 2008 includes Rio Grande's receivable balances from BP of \$0.6 million and \$0.8 million, respectively.

Note 10: HEP Partners Equity, Income Allocations, Cash Distributions and Comprehensive Income

Issuances of units

As of September 30, 2009, Holly holds 7,290,000 of our common units and the 2% general partner interest, which together constitutes a 41% ownership interest in us. In August 2009, all of the conditions necessary to end the subordination period for the 7,000,000 subordinated units owned by Holly were met and the units were converted into our common units on a one-for-one basis.

Currently, Alon owns all 937,500 of our Class B subordinated units. The subordination period of these units extends until the first day of any quarter beginning after March 31, 2010 provided Alon is not in default with respect to payments due under its minimum volume commitments under the Alon PTA for each of the three consecutive, non-overlapping four-quarter periods immediately preceding such date. At the end of the subordination period, the Class B subordinated units will convert into our common units on a one-for-one basis.

In May 2009, we closed a public offering of 2,192,400 of our common units priced at \$27.80 per unit including 192,400 common units issued pursuant to the underwriters' exercise of their over-allotment option. Net proceeds of \$58.4 million were used to repay bank debt and for general partnership purposes. In addition, we received a \$1.2 million capital contribution from our general partner to maintain its 2% general partner interest.

Under our registration statement filed with the SEC using a shelf registration process, we currently have the ability to raise approximately \$940.0 million through security offerings, through one or more prospectus supplements that would describe, among other things, the specific amounts, prices and terms of any securities offered and how the proceeds would be used. Any proceeds from the sale of securities would be used for general business purposes, which may include, among other things, funding acquisitions of assets or businesses, working capital, capital expenditures, investments in subsidiaries, the retirement of existing debt and/or the repurchase of common units or other securities.

Allocations of Net Income

Net income attributable to Holly Energy Partners, L.P. is allocated between limited partners and the general partner interest in accordance with the provisions of the partnership agreement. HEP net income allocated to the general partner includes incentive distributions that are declared subsequent to quarter end. After the amount of incentive distributions is allocated to the general partner, the remaining net income attributable to HEP is generally allocated to the partners based on their weighted average ownership percentage during the period.

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The following table presents the allocation of the general partner interest in net income attributable to HEP:

	Three Months Ended		Nine Months Ended	
	September 30, 2009	September 30, 2008	September 30, 2009	September 30, 2008
	(In thousands, except per unit data)			
General partner interest in net income	\$ 300	\$ 115	\$ 691	\$ 316
General partner incentive distribution	1,722	893	4,472	2,420
 Total general partner interest in net income attributable to HEP	 \$ 2,022	 \$ 1,008	 \$ 5,163	 \$ 2,736

Cash Distributions

We consider regular cash distributions to unitholders on a quarterly basis, although there is no assurance as to the future cash distributions since they are dependent upon future earnings, cash flows, capital requirements, financial condition and other factors. Our Credit Agreement prohibits us from making cash distributions if any potential default or event of default, as defined in the agreement, occurs or would result from the cash distribution.

Our general partner, HEP Logistics Holdings, L.P., is entitled to incentive distributions if the amount we distribute with respect to any quarter exceeds specified target levels.

On October 22, 2009, we announced our cash distribution for the third quarter of 2009 of \$0.795 per unit. The distribution is payable on all common, subordinated and general partner units and will be paid November 13, 2009 to all unitholders of record on November 2, 2009.

The following table presents the allocation of our regular quarterly cash distributions to the general and limited partners for the periods to which they apply. Our distributions are declared subsequent to quarter end, therefore the amounts presented do not reflect distributions paid in the periods presented below.

	Three Months Ended		Nine Months Ended	
	September 30, 2009	September 30, 2008	September 30, 2009	September 30, 2008
	(In thousands, except per unit data)			
General partner interest	\$ 336	\$ 268	\$ 947	\$ 792
General partner incentive distribution	1,722	893	4,472	2,420
 Total general partner distribution	 2,058	 1,161	 5,419	 3,212
 Limited partner distribution	 14,723	 12,357	 41,938	 36,591
 Total regular quarterly cash distribution	 \$ 16,781	 \$ 13,518	 \$ 47,357	 \$ 39,803
 Cash distribution per unit applicable to limited partners	 \$ 0.795	 \$ 0.755	 \$ 2.355	 \$ 2.235

As a master limited partnership, we distribute our available cash, which has historically exceeded our net income because depreciation and amortization expense represents a non-cash charge against income. The result is a decline in equity since our regular quarterly distributions have exceeded our quarterly net income.

Table of Contents***Comprehensive Income***

We have other comprehensive income resulting from fair value adjustments to our cash flow hedge. Our comprehensive income is as follows:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2009	2008	2009	2008
	(In thousands)			
Net income	\$ 16,808	\$ 6,785	\$ 39,561	\$ 19,068
Other comprehensive income:				
Change in fair value of cash flow hedge	(1,482)	(1,623)	2,786	825
Comprehensive income	15,326	5,162	42,347	19,893
Less noncontrolling interest in comprehensive income	269	164	1,191	834
Comprehensive income attributable to HEP unitholders	\$ 15,057	\$ 4,998	\$ 41,156	\$ 19,059

Note 11: Supplemental Guarantor/Non-Guarantor Financial Information

Obligations of Holly Energy Partners, L.P. (Parent) under the 6.25% Senior Notes have been jointly and severally guaranteed by each of its direct and indirect wholly-owned subsidiaries (Guarantor Subsidiaries). These guarantees are full and unconditional. Rio Grande (Non-Guarantor), in which we have a 70% ownership interest, is the only subsidiary that has not guaranteed these obligations.

The following financial information presents condensed consolidating balance sheets, statements of income, and statements of cash flows of the Parent, the Guarantor Subsidiaries and the Non-Guarantor. The information has been presented as if the Parent accounted for its ownership in the Guarantor Subsidiaries, and the Guarantor Subsidiaries accounted for the ownership of the Non-Guarantor, using the equity method of accounting.

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Table of Contents**Condensed Consolidating Balance Sheet**

September 30, 2009	Parent	Guarantor Subsidiaries	Non- Guarantor (In thousands)	Eliminations	Consolidated
ASSETS					
Current assets:					
Cash and cash equivalents	\$ 2	\$ 303	\$ 3,745	\$	\$ 4,050
Accounts receivable		14,589	1,552		16,141
Intercompany accounts receivable (payable)	(191,973)	191,983	(10)		
Prepaid and other current assets	387	683			1,070
Total current assets	(191,584)	207,558	5,287		21,261
Properties and equipment, net		317,612	31,450		349,062
Investment in subsidiaries	425,592	25,222		(450,814)	
Transportation agreements, net		117,173			117,173
Investment in SLC Pipeline		26,809			26,809
Other assets	3,669	991			4,660
Total assets	\$ 237,677	\$ 695,365	\$ 36,737	\$ (450,814)	\$ 518,965
LIABILITIES AND EQUITY					
Current liabilities:					
Accounts payable	\$	\$ 4,699	\$ 267	\$	\$ 4,966
Accrued interest	(888)	1,804			916
Deferred revenue		7,582			7,582
Accrued property taxes		1,348	138		1,486
Other current liabilities	2,442	(1,375)	301		1,368
Total current liabilities	1,554	14,058	706		16,318
Long-term debt	184,819	245,000			429,819
Other long-term liabilities	3,044	10,715			13,759
Equity HEP	48,260	425,592	36,031	(461,623)	48,260
Equity noncontrolling interest				10,809	10,809
Total liabilities and equity	\$ 237,677	\$ 695,365	\$ 36,737	\$ (450,814)	\$ 518,965

Condensed Consolidating Balance Sheet

December 31, 2008	Parent	Guarantor Subsidiaries	Non- Guarantor (In thousands)	Eliminations	Consolidated
ASSETS					
Current assets:					
Cash and cash equivalents	\$ 2	\$ 3,706	\$ 1,561	\$	\$ 5,269

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Accounts receivable		13,332	1,145		14,477
Intercompany accounts receivable (payable)	(197,828)	197,979	(151)		
Prepaid and other current assets	176	417			593
Total current assets	(197,650)	215,434	2,555		20,339
Properties and equipment, net		257,886	32,398		290,284
Investment in subsidiaries	378,481	23,842		(402,323)	
Transportation agreements, net		122,383			122,383
Other assets	5,300	1,382			6,682
Total assets	\$ 186,131	\$ 620,927	\$ 34,953	\$ (402,323)	\$ 439,688
LIABILITIES AND EQUITY					
Current liabilities:					
Accounts payable	\$	\$ 7,357	\$ 661	\$	\$ 8,018
Accrued interest	(27,778)	30,623			2,845
Deferred revenue		15,658			15,658
Accrued property taxes		1,015	130		1,145
Other current liabilities	31,214	(29,811)	102		1,505
Short-term borrowings under credit agreement		29,000			29,000
Total current liabilities	3,436	53,842	893		58,171
Long-term debt	184,793	171,000			355,793
Other long-term liabilities		17,604			17,604
Equity HEP	(2,098)	378,481	34,060	(412,541)	(2,098)
Equity noncontrolling interest				10,218	10,218
Total liabilities and equity	\$ 186,131	\$ 620,927	\$ 34,953	\$ (402,323)	\$ 439,688

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Revenues:					
Affiliates	\$	\$ 22,737	\$	\$	\$ 22,737
Third parties		5,437	1,663	(326)	6,774
		28,174	1,663	(326)	29,511
Operating costs and expenses:					
Operations		10,593	766	(326)	11,033
Depreciation and amortization		5,538	346		5,884
General and administrative	887	710	(1)		1,596
	887	16,841	1,111	(326)	18,513
Operating income (loss)	(887)	11,333	552		10,998
Other income (expense):					
Equity in earnings of subsidiaries	10,189	385		(10,574)	
Interest income (expense)	(2,681)	(2,463)	8		(5,136)
Other income		1,007			1,007
	7,508	(1,071)	8	(10,574)	(4,129)
Income (loss) before income taxes	6,621	10,262	560	(10,574)	6,869
State income tax		(73)	(11)		(84)
Net income	6,621	10,189	549	(10,574)	6,785
Less noncontrolling interest in net income				164	164
Net income attributable to HEP	\$ 6,621	\$ 10,189	\$ 549	\$ (10,738)	\$ 6,621

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Table of Contents**Condensed Consolidating Statement of Income**

Nine months ended September 30, 2009	Parent	Guarantor Subsidiaries	Non- Guarantor	Eliminations	Consolidated
			(In thousands)		
Revenues:					
Affiliates	\$	\$ 71,746	\$	\$	\$ 71,746
Third parties		37,430	7,334	(1,040)	43,724
		109,176	7,334	(1,040)	115,470
Operating costs and expenses:					
Operations		32,091	2,281	(1,040)	33,332
Depreciation and amortization		18,909	1,020		19,929
General and administrative	3,195	1,784	11		4,990
	3,195	52,784	3,312	(1,040)	58,251
Operating income (loss)	(3,195)	56,392	4,022		57,219
Other income (expense):					
Equity in earnings of subsidiaries	50,026	2,780		(52,806)	
Equity in earnings of SLC Pipeline		1,309			1,309
SLC Pipeline acquisition costs		(2,500)			(2,500)
Interest income (expense)	(8,461)	(7,754)			(16,215)
Other		65			65
	41,565	(6,100)		(52,806)	(17,341)
Income (loss) before income taxes	38,370	50,292	4,022	(52,806)	39,878
State income tax		(266)	(51)		(317)
Net income	38,370	50,026	3,971	(52,806)	39,561
Less noncontrolling interest in net income				1,191	1,191
Net income attributable to HEP	\$ 38,370	\$ 50,026	\$ 3,971	\$ (53,997)	\$ 38,370

Condensed Consolidating Statement of Income

Guarantor Non-

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Nine months ended September 30, 2008	Parent	Subsidiaries	Guarantor	Eliminations	Consolidated
	(In thousands)				
Revenues:					
Affiliates	\$	\$ 61,210	\$	\$	\$ 61,210
Third parties		16,735	6,584	(967)	22,352
		77,945	6,584	(967)	83,562
Operating costs and expenses:					
Operations		28,908	2,804	(967)	30,745
Depreciation and amortization		15,262	997		16,259
General and administrative	2,389	1,856	(4)		4,241
	2,389	46,026	3,797	(967)	51,245
Operating income (loss)	(2,389)	31,919	2,787		32,317
Other income (expense):					
Equity in earnings of subsidiaries	28,923	1,947		(30,870)	
Interest income (expense)	(8,300)	(5,795)	40		(14,055)
Gain on sale of assets		36			36
Other income		1,007			1,007
	20,623	(2,805)	40	(30,870)	(13,012)
Income (loss) before income taxes	18,234	29,114	2,827	(30,870)	19,305
State income tax		(191)	(46)		(237)
Net income	18,234	28,923	2,781	(30,870)	19,068
Less noncontrolling interest in net income				834	834
Net income attributable to HEP	\$ 18,234	\$ 28,923	\$ 2,781	\$ (31,704)	\$ 18,234

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Table of Contents**Condensed Consolidating Statement of Cash Flows**

Nine months ended September 30, 2009	Parent	Guarantor Subsidiaries	Non- Guarantor	Eliminations	Consolidated
			(in thousands)		
Cash flows from operating activities	\$ (14,271)	\$ 56,203	\$ 4,256	\$ (1,400)	\$ 44,788
Cash flows from investing activities					
Investment in SLC Pipeline		(25,500)			(25,500)
Additions to properties and equipment		(73,406)	(72)		(73,478)
		(98,906)	(72)		(98,978)
Cash flows from financing activities					
Net borrowings under credit agreement		45,000			45,000
Proceeds from issuance of common units	58,355				58,355
Capital contribution from general partner	1,191				1,191
Distributions to HEP unitholders	(44,393)		(2,000)	2,000	(44,393)
Purchase price in excess of transferred basis in Tulsa loading racks		(5,700)			(5,700)
Distributions to noncontrolling interest				(600)	(600)
Other financing activities, net	(882)				(882)
	14,271	39,300	(2,000)	1,400	52,971
Cash and cash equivalents					
Increase (decrease) for the period		(3,403)	2,184		(1,219)
Beginning of period	2	3,706	1,561		5,269
End of period	\$ 2	\$ 303	\$ 3,745	\$	\$ 4,050

Condensed Consolidating Statement of Cash Flows

Nine months ended September 30, 2008	Parent	Guarantor Subsidiaries	Non- Guarantor	Eliminations	Consolidated
			(in thousands)		
Cash flows from operating activities	\$ (44,408)	\$ 81,053	\$ 4,245	\$ (2,800)	\$ 38,090
Cash flows from investing activities					
Additions to properties and equipment		(28,530)	(494)		(29,024)
Acquisition of crude pipelines and tankage assets		(171,000)			(171,000)
Proceeds from sale of assets		36			36

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(199,494) (494) (199,988)

Cash flows from financing activities

Net borrowings under credit agreement	9,000	186,000			195,000
Proceeds from issuance of common units		104			104
Capital contribution from general partner	186				186
Distributions to HEP unitholders	(38,908)		(4,000)	4,000	(38,908)
Distributions to noncontrolling interest				(1,200)	(1,200)
Other financing activities, net	(795)	(692)			(1,487)

(30,517) 185,412 (4,000) 2,800 153,695

Cash and cash equivalents

Increase (decrease) for the period	(74,925)	66,971	(249)		(8,203)
Beginning of period	2	8,060	2,259		10,321

End of period \$ (74,923) \$ 75,031 \$ 2,010 \$ 2,118

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Note 12: Subsequent Events

On October 20, 2009, we announced an agreement with Sinclair Oil Company (Sinclair) to purchase certain logistics and storage assets consisting of storage tanks having approximately 1.4 million barrels of storage capacity, loading racks and a refined product delivery pipeline at Sinclair 's refinery located in Tulsa, Oklahoma. Our \$75.0 million purchase price will consist of \$21.5 million in cash and \$53.5 million in our common units. We expect to finance the cash portion of this acquisition with our existing cash balances, the sale of additional limited partner units and/or borrowings under our Credit Agreement. Separately Holly, also a party to the agreement, announced an agreement to purchase the refining assets at Sinclair 's Tulsa refinery. In conjunction with these transactions, we expect to enter into a long-term agreement with Holly to provide certain storage, loading, delivery and receiving services associated with the new assets.

On October 19, 2009 BP, our Rio Grande joint venture partner, consented to an agreement between us, HEP Navajo Southern, L.P. (one of our wholly-owned subsidiaries) and Enterprise Products Operating LLC (Enterprise) under which we have agreed to sell HEP Navajo Southern, L.P. 's 70% ownership interest in Rio Grande to Enterprise for \$35.0 million. We expect the closing of this transaction to occur in December 2009 at which time we will recognize a gain.

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HOLLY ENERGY PARTNERS, L.P.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This Item 2, including but not limited to the sections on Results of Operations and Liquidity and Capital Resources, contains forward-looking statements. See Forward-Looking Statements at the beginning of Part I. In this document, the words we, our, ours and us refer to HEP and its consolidated subsidiaries or to HEP or an individual subsidiary and not to any other person.

OVERVIEW

Holly Energy Partners, L.P. (HEP) is a Delaware limited partnership. We own and operate substantially all of the petroleum product and crude oil pipeline and terminal, tankage and loading rack assets that support the Holly Corporation (Holly) refining and marketing operations in west Texas, New Mexico, Utah, Oklahoma, Idaho and Arizona and a 70% interest in Rio Grande Pipeline Company (Rio Grande). Holly currently owns a 41% interest in us. We also own and operate refined product pipelines and terminals, located primarily in Texas, that service Alon USA, Inc.'s (Alon) refinery in Big Spring, Texas.

We operate a system of petroleum product and crude oil pipelines in Texas, New Mexico, Oklahoma and Utah and tankage and distribution terminals in Texas, New Mexico, Arizona, Utah, Oklahoma, Idaho and Washington. We generate revenues by charging tariffs for transporting petroleum products and crude oil through our pipelines, by charging fees for terminalling refined products and other hydrocarbons and storing and providing other services at our storage tanks and terminals. We do not take ownership of products that we transport or terminal; therefore, we are not directly exposed to changes in commodity prices.

On August 1, 2009, we acquired from Holly certain truck and rail loading/unloading facilities (the Tulsa Loading Racks) located at Holly's refinery in Tulsa, Oklahoma (the Tulsa Refinery) for \$17.5 million. The racks load refined products produced at the Tulsa Refinery onto rail cars and/or tanker trucks for delivery to surrounding markets.

On June 1, 2009, we acquired a newly constructed 16-inch intermediate pipeline from Holly for \$34.2 million. The pipeline runs 65 miles from Holly's crude oil distillation and vacuum facilities in Lovington, New Mexico to its petroleum refinery located in Artesia, New Mexico (collectively, the Navajo Refinery). This pipeline operates as a component of our intermediate pipeline system that services Holly's Navajo Refinery.

Additionally in March 2009, we acquired a 25% joint venture interest in a new 95-mile intrastate pipeline system (the SLC Pipeline) jointly owned by Plains All American Pipeline, L.P. (Plains) and us. The SLC Pipeline allows various refiners in the Salt Lake City area, including Holly's Woods Cross refinery, to ship crude oil into the Salt Lake City area from the Utah terminus of the Frontier Pipeline as well as crude oil flowing from Wyoming and Utah via Plains Rocky Mountain Pipeline. The SLC Pipeline commenced pipeline operations effective March 2009.

In May 2009, we closed a public offering of 2,192,400 of our common units priced at \$27.80 per unit including 192,400 common units issued pursuant to the underwriters' exercise of their over-allotment option. Net proceeds of \$58.4 million were used to repay bank debt and for general partnership purposes. In addition, we received a \$1.2 million capital contribution from our general partner to maintain its 2% general partner interest.

In March 2009 Holly, our largest customer, completed a 15,000 barrels per day (bpd) capacity expansion of its Navajo Refinery increasing refining capacity to 100,000 bpd, or by 18%.

For the nine months ended September 30, 2009, our revenues were \$115.5 million compared to \$83.6 million for the nine months ended September 30, 2008. Our total operating costs and expenses for the nine months ended September 30, 2009 were \$58.3 million compared to \$51.2 million for the same period of 2008.

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Net income attributable to HEP was \$33.2 million (\$1.89 per basic and diluted limited partner unit) for the nine months ended September 30, 2009 compared to \$15.5 million (\$0.95 per basic and diluted limited partner unit) for the same period of 2008.

Agreements with Holly Corporation and Alon

As of September 30, 2009, we serve Holly's refineries in New Mexico, Utah and Oklahoma under multiple long-term pipeline and terminal, tankage and throughput agreements. The substantial majority of our business is devoted to providing transportation, storage and terminalling services to Holly.

These agreements relate to the pipelines and terminals contributed to us from Holly at the time of our initial public offering in 2004 (the Holly PTA), the intermediate pipelines acquired in 2005 and in June 2009 (the Holly IPA), the crude pipelines and tankage assets acquired in 2008 (the Holly CPTA) and the Tulsa Loading Racks acquired in August 2009 (the Holly ETA).

In connection with our purchase of Holly's 16-inch intermediate pipeline in June 2009, we amended the Holly IPA, increasing Holly's contractual minimum revenue commitment and extending the term of the agreement by additional 5 year period.

Under these agreements, Holly agreed to transport and store volumes of refined product and crude oil on our pipelines and terminal and tankage facilities that result in minimum annual payments to us. These minimum annual payments or revenues will be adjusted each year at a percentage change based upon the change in the Producer Price Index (PPI) but will not decrease as a result of a decrease in the PPI. Under these agreements, the agreed upon tariff rates are adjusted each year on July 1 at a rate based upon the percentage change in the PPI or the Federal Energy Regulatory Commission (FERC) Oil Pipeline Index, but generally will not decrease as a result of a decrease in the PPI or FERC index. The FERC index is the change in the PPI plus a FERC adjustment factor that is reviewed periodically.

We also have a pipelines and terminals agreement with Alon expiring in 2020, under which Alon has agreed to transport on our pipelines and throughput through our terminals volumes of refined products that results in a minimum level of annual revenue. The agreed upon tariffs are increased or decreased annually at a rate equal to the percentage change in the PPI, but not below the initial tariff rate.

At July 1, 2009, contractual minimums under our long-term service agreements are as follows:

Agreement	Minimum Annualized Commitment (In millions)	Year of Maturity	Contract Type
Holly PTA	\$ 43.7	2019	Minimum revenue commitment
Holly IPA*	20.7	2024	Minimum revenue commitment
Holly CPTA	28.4	2023	Minimum revenue commitment
Holly ETA	2.7	2024	Minimum revenue commitment
Alon PTA	21.7	2020	Minimum volume commitment
Alon capacity lease	6.4	Various	Capacity lease
Total	\$ 123.6		

* Reflects amended terms of the Holly IPA effective June 2009.

We depend on our agreements with Holly and Alon for the majority of our revenues. A significant reduction in revenues under these agreements would have a material adverse effect on our results of operations.

Under certain provisions of an omnibus agreement that we have with Holly (the Omnibus Agreement), we pay Holly an annual administrative fee, currently \$2.3 million, for the provision by Holly or its affiliates of various general and administrative services to us. This fee does not include the salaries of pipeline and terminal personnel or the cost of their employee benefits, which are separately charged to us by Holly. We also reimburse Holly and its affiliates for direct expenses they incur on our behalf.

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Table of Contents**RESULTS OF OPERATIONS (Unaudited)****Income, Distributable Cash Flow and Volumes**

The following tables present income, distributable cash flow and volume information for the three and nine months ended September 30, 2009 and 2008.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
	(In thousands, except per unit data)			
Revenues				
Pipelines:				
Affiliates refined product pipelines	\$ 12,267	\$ 10,553	\$ 31,186	\$ 28,994
Affiliates intermediate pipelines	5,370	2,953	11,438	9,002
Affiliates crude pipelines	7,563	6,776	21,215	15,524
	25,200	20,282	63,839	53,520
Third parties refined product pipelines	12,491	5,773	38,459	19,289
	37,691	26,055	102,298	72,809
Terminals, refinery tankage and loading racks:				
Affiliates	3,159	2,455	7,907	7,690
Third parties	1,894	1,001	5,265	3,063
	5,053	3,456	13,172	10,753
Total revenues	42,744	29,511	115,470	83,562
Operating costs and expenses:				
Operations	11,450	11,033	33,332	30,745
Depreciation and amortization	6,820	5,884	19,929	16,259
General and administrative	1,848	1,596	4,990	4,241
	20,118	18,513	58,251	51,245
Operating income	22,626	10,998	57,219	32,317
Other income (expense):				
Equity in earnings of SLC Pipeline	711		1,309	
SLC Pipeline acquisition costs			(2,500)	
Interest income	2	25	10	146
Interest expense, including amortization	(6,418)	(5,161)	(16,225)	(14,201)
Other		1,007	65	1,043
	(5,705)	(4,129)	(17,341)	(13,012)

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Income before income taxes	16,921	6,869	39,878	19,305
State income tax	(113)	(84)	(317)	(237)
Net income⁽⁸⁾	16,808	6,785	39,561	19,068
Less noncontrolling interest in net income ⁽⁸⁾	269	164	1,191	834
Net income attributable to HEP⁽⁸⁾	16,539	6,621	38,370	18,234
Less general partner interest in net income attributable to HEP, including incentive distributions ⁽¹⁾	2,022	1,008	5,163	2,736
Limited partners interest in net income attributable to HEP	\$ 14,517	\$ 5,613	\$ 33,207	\$ 15,498
Limited partners per unit interest in net income attributable to HEP basic and diluted⁽¹⁾⁽⁹⁾	\$ 0.78	\$ 0.34	\$ 1.89	\$ 0.95
Weighted average limited partners units outstanding	18,520	16,328	17,546	16,279
EBITDA ⁽²⁾	\$ 29,888	\$ 17,725	\$ 74,831	\$ 48,785
Distributable cash flow ⁽³⁾	\$ 20,678	\$ 15,749	\$ 51,677	\$ 43,452
Volumes barrels per day (bpd)				
Pipelines:				
Affiliates refined product pipelines	98,987	79,192	85,489	79,852
Affiliates intermediate pipelines	88,053	54,583	64,494	58,014
Affiliates crude pipelines	143,902	132,120	136,315	103,465
	330,942	265,895	286,298	241,331
Third parties refined product pipelines	55,384	25,046	59,471	31,635
	386,326	290,941	345,769	272,966
Terminals and loading racks:				
Affiliates	122,413	102,128	106,969	107,611
Third parties	44,459	27,845	42,873	32,073

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	166,872	129,973	149,842	139,684
Total for pipelines and terminal assets (bpd)	553,198	420,914	495,611	412,650

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- (1) Net income attributable to HEP is allocated between limited partners and the general partner interest in accordance with the provisions of the partnership agreement. HEP net income allocated to the general partner includes incentive distributions declared subsequent to quarter end. General partner incentive distributions for the three months ended September 30, 2009 and 2008 were \$1.7 million and \$0.9 million, respectively, and for the nine months ended September 30, 2009 and 2008 were \$4.5 million and \$2.4 million, respectively. HEP net income attributable to the limited partners is divided by the weighted average limited partner units outstanding in computing the

limited partners
per unit interest
in HEP net
income.

- (2) Earnings before interest, taxes, depreciation and amortization (EBITDA) is calculated as net income attributable to HEP plus (i) interest expense net of interest income, (ii) state income tax and (iii) depreciation and amortization. EBITDA is not a calculation based upon U.S. generally accepted accounting principles (U.S. GAAP). However, the amounts included in the EBITDA calculation are derived from amounts included in our consolidated financial statements. EBITDA should not be considered as an alternative to net income or operating income, as an indication of our operating performance or as an alternative

to operating cash flow as a measure of liquidity. EBITDA is not necessarily comparable to similarly titled measures of other companies. EBITDA is presented here because it is a widely used financial indicator used by investors and analysts to measure performance. EBITDA is also used by our management for internal analysis and as a basis for compliance with financial covenants.

Set forth below is our calculation of EBITDA.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
	(In thousands)			
Net income attributable to HEP	\$ 16,539	\$ 6,621	\$ 38,370	\$ 18,234
Add (subtract):				
Interest expense	5,314	4,902	15,396	13,462
Amortization of discount and deferred debt issuance costs	176	259	529	739
Increase in interest expense change in fair value of interest rate swaps	928		300	
Interest income	(2)	(25)	(10)	(146)
State income tax	113	84	317	237
Depreciation and amortization	6,820	5,884	19,929	16,259
EBITDA	\$ 29,888	\$ 17,725	\$ 74,831	\$ 48,785

(3)

Distributable cash flow is not a calculation based upon U.S. GAAP.

However, the amounts included in the calculation are derived from amounts separately presented in our consolidated financial statements, with the exception of maintenance capital expenditures.

Distributable cash flow should not be considered in isolation or as an alternative to net income or operating income, as an indication of our operating performance or as an alternative to operating cash flow as a measure of liquidity.

Distributable cash flow is not necessarily comparable to similarly titled measures of other companies.

Distributable cash flow is presented here because it is a widely accepted financial

indicator used
by investors to
compare
partnership
performance.
We believe that
this measure
provides
investors an
enhanced
perspective of
the operating
performance of
our assets and
the cash our
business is
generating.

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Set forth below is our calculation of distributable cash flow.

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2009	2008	2009	2008
	(In thousands)			
Net income attributable to HEP	\$ 16,539	\$ 6,621	\$ 38,370	\$ 18,234
Add (subtract):				
Depreciation and amortization	6,820	5,884	19,929	16,259
Amortization of discount and deferred debt issuance costs	176	259	529	739
Increase in interest expense change in fair value of interest rate swaps	928		300	
Equity in excess cash flows over earnings of SLC Pipeline	167		387	
Increase (decrease) in deferred revenue	(3,407)	3,857	(8,076)	10,638
SLC Pipeline acquisition costs*			2,500	
Maintenance capital expenditures**	(545)	(872)	(2,262)	(2,418)
Distributable cash flow	\$ 20,678	\$ 15,749	\$ 51,677	\$ 43,452

* Under provisions of Accounting Standards Codification (ASC) Topic Business Combinations (previously Statement of Financial Accounting Standard (SFAS) No. 141(R)), effective January 1, 2009, we were required to expense rather than capitalize certain acquisition costs of \$2.5 million associated with our joint venture

agreement with Plains that closed in March 2009. As these costs directly relate to our interest in the new joint venture pipeline and are similar to expansion capital expenditures, we have added back these costs to arrive at distributable cash flow.

** Maintenance capital expenditures are capital expenditures made to replace partially or fully depreciated assets in order to maintain the existing operating capacity of our assets and to extend their useful lives.

(4) The amount reported for the nine months ended September 30, 2008 include volumes transported on the crude pipelines for the period from March 1, 2008 through September 30, 2008 only.

Volumes shipped during the months of March through September 2008 averaged 132.5 thousand barrels per day (mbpd). For the nine months ended September 30, 2008, crude pipeline volumes are based on volumes for the months of March through September, averaged over the 274 days in the first nine months of 2008. Under the Holly CPTA, fees are based on volumes transported on each pipeline component comprising the crude pipeline system (the crude oil gathering pipelines and the crude oil trunk lines). Accordingly, volumes transported on the crude pipelines represent the sum of volumes transported on both pipeline components. In cases where volumes are transported over both components

of the crude pipeline system, such volumes are reflected twice in the total crude oil pipeline volumes.

**September
30,
2009** **December 31,
2008**
(In thousands)

Balance Sheet Data

Cash and cash equivalents	\$ 4,050	\$ 5,269
Working capital ⁽⁵⁾	\$ 4,943	\$ (37,832)
Total assets ⁽⁶⁾	\$518,965	\$439,688
Long-term debt ⁽⁷⁾	\$429,819	\$355,793
Total equity ⁽⁶⁾⁽⁸⁾	\$ 59,069	\$ 8,120

(5) Working capital at December 31, 2008 reflects \$29.0 million of credit agreement advances that were classified as short-term borrowings.

(6) As a master limited partnership, we distribute our available cash, which historically has exceeded net income because depreciation and amortization expense represents a non-cash charge against income. The result is a decline in equity since our regular quarterly distributions

have exceeded
our quarterly net
income.

Additionally, if
the assets
transferred to us
upon our initial
public offering
in 2004, the
intermediate
pipelines
purchased from
Holly in 2005
and the Tulsa
Loading Racks
purchased in
August 2009
had been
acquired from
third parties, our
acquisition

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cost in excess of Holly's basis in the transferred assets of \$163.0 million would have been recorded as increases to our properties and equipment and intangible assets instead of reductions to equity.

- (7) Includes \$245.0 million of credit agreement advances that were classified as long-term debt at September 30, 2009.
- (8) On January 1, 2009, we adopted accounting standards under ASC Topic Noncontrolling Interest in a Subsidiary (previously SFAS No. 160). As a result, net income attributable to the noncontrolling interest in our Rio Grande subsidiary is now presented as an adjustment to net income to arrive at Net

income attributable to Holly Energy Partners, L.P. in our Consolidated Statements of Income. Prior to our adoption of these standards, this amount was presented as

Minority interest in Rio Grande, a non-operating expense item before Income before income taxes.

Additionally, equity attributable to noncontrolling interests in our Rio Grande subsidiary is now presented as a separate component of total equity in our Consolidated Financial Statements. We have applied these standards on a retrospective basis. While this presentation differs from previous U.S. GAAP requirements, it did not affect our net income and equity attributable to HEP.

- (9) On January 1, 2009, we also adopted accounting standards under ASC Topic Earnings Per Share (previously Emerging Issues Task Force (EITF) No. 07-4), which prescribe the application of the two-class method in computing earnings per unit to reflect a master limited partnership s contractual obligation to make distributions to the general partner, limited partners and incentive distribution rights holders. As a result, our quarterly earnings allocations to the general partner now include incentive distributions that were declared subsequent to quarter end. Prior to our adoption of these standards, our general partner earnings allocations

included incentive distributions that were declared during each quarter. We have applied these standards on a retrospective basis. The adoption of these standards resulted in a decrease in our limited partners interest in net income attributable to Holly Energy Partners, L.P. for the three and nine months ended September 30, 2008, reducing earnings per limited partner unit by \$.01 to \$0.34 and \$0.95 for the three and nine months ended September 30, 2008, respectively.

Results of Operations Three Months Ended September 30, 2009 Compared with Three Months Ended September 30, 2008

Summary

Net income attributable to HEP for the three months ended September 30, 2009 was \$16.5 million, a \$9.9 million increase compared to the same period in 2008. This increase was due principally to increased shipments on our pipeline systems, the effect of the July 2009 annual tariff increases on affiliate pipeline shipments and an increase in previously deferred revenue realized. These factors were partially offset by an increase in operating costs and expenses. Our revenues for the three months ended September 30, 2009 include the recognition of \$5.1 million of prior shortfalls billed to shippers in 2008 as they did not meet their minimum volume commitments in any of the subsequent four quarters. Revenue of \$1.6 million relating to deficiency payments associated with certain guaranteed shipping contracts was deferred during the three months ended September 30, 2009. Such revenue will be recognized in future periods either as payment for shipments in excess of guaranteed levels or when shipping rights expire unused after a twelve-month period.

Revenues

Total revenues for the three months ended September 30, 2009 were \$42.7 million, a \$13.2 million increase compared to the three months ended September 30, 2008. This increase was due principally to overall increased shipments on our pipeline systems, the effect of the July 2009 annual tariff increase on affiliate pipeline shipments and an increase in previously deferred revenue realized. Increased volumes attributable to Holly's 15,000 barrels per stream day expansion of the Navajo Refinery, including volumes shipped on our new 16-inch pipeline, contributed to a 24% increase in affiliate pipeline shipments. Additionally, third-party refined product shipments were up for the quarter compared to last year's third quarter, which were down as a result of limited production resulting from an explosion and fire at Alon's Big Spring refinery in the first quarter of 2008.

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Revenues from our refined product pipelines were \$24.8 million, an increase of \$8.4 million compared to the third quarter of 2008. This increase was due to increased shipments on our refined product pipeline system, the effect of the July 2009 annual tariff increase on affiliate refined product shipments and a \$3.4 million increase in previously deferred revenue realized. Shipments on our refined product pipeline system increased to an average of 154.4 mbpd compared to 104.2 mbpd for the same period last year.

Revenues from our intermediate pipelines were \$5.4 million, an increase of \$2.4 million compared to the third quarter of 2008. This increase was due to increased shipments on our intermediate pipeline system including volumes shipped on our new 16-inch pipeline, the effect of the July 2009 annual tariff increase on intermediate pipeline shipments and a \$0.4 million increase in previously deferred revenue realized. Shipments on our intermediate product pipeline system increased to an average of 88.1 mbpd compared to 54.6 mbpd for the same period last year.

Revenues from our crude pipelines were \$7.6 million, an increase of \$0.8 million compared to the third quarter of 2008. Shipments on our crude pipeline system increased to an average of 143.9 mbpd compared to 132.1 mbpd for the same period last year.

Revenues from terminal, tankage and loading rack fees were \$5.1 million, an increase of \$1.6 million compared to the third quarter of 2008. This increase includes \$0.5 million in revenues attributable to volumes transferred via our Tulsa Loading Racks beginning August 1, 2009. Refined products terminalled in our facilities increased to an average of 166.9 mbpd compared to 130.0 mbpd for the same period last year.

Operating Costs

Operations expense for three months ended September 30, 2009 increased by \$0.4 million compared to the three months ended September 30, 2008. This increase was due principally to costs attributable to higher throughput volumes.

Depreciation and Amortization

Depreciation and amortization for the three months ended September 30, 2009 increased by \$0.9 million compared to the three months ended September 30, 2008. This increase was due to increased depreciation attributable to asset acquisitions and capital projects.

General and Administrative

General and administrative costs for the three months ended September 30, 2009 increased by \$0.3 million compared to the three months ended September 30, 2008. This increase was due principally to increased professional fees.

Equity in earnings of SLC Pipeline

The SLC Pipeline commenced pipeline operations effective March 2009. Our equity in earnings of the SLC Pipeline was \$0.7 million for the three months ended September 30, 2009.

Interest Expense

Interest expense for the three months ended September 30, 2009 totaled \$6.4 million, an increase of \$1.3 million compared to the three months ended September 30, 2008. This was due to the effects of interest attributable to advances from our revolving credit agreement that were used to finance asset acquisitions as well as capital projects, offset by the effects of a lower effective interest rate. Additionally for the three months ended September 30, 2009, fair value adjustments to our interest rate swaps resulted in a \$0.9 million non-cash increase in interest expense. Excluding the effects of these fair value adjustments, our aggregate effective interest rate was 5.2% for the three months ended September 30, 2009 compared to 5.5% for the same period last year.

Table of Contents***State Income Tax***

State income taxes were \$0.1 million for each of the three months ended September 30, 2009 and 2008.

Results of Operations – Nine Months Ended September 30, 2009 Compared with Nine Months Ended September 30, 2008***Summary***

Net income attributable to HEP for the nine months ended September 30, 2009 was \$38.4 million, a \$20.1 million increase compared to the same period in 2008. This increase was due principally to increased shipments on our pipeline systems, increased revenues attributable to our crude pipeline assets acquired in the first quarter of 2008, the effect of the July 2009 annual tariff increase on affiliate pipeline shipments and an increase in previously deferred revenue realized. Additionally, we incurred acquisition costs of \$2.5 million that relate to the acquisition of our SLC Pipeline joint venture interest in March 2009. Our revenues for the nine months ended September 30, 2009 include the recognition of \$13.8 million of prior shortfalls billed to shippers in 2008 as they did not meet their minimum volume commitments in any of the subsequent four quarters. Revenue of \$6.7 million relating to deficiency payments associated with certain guaranteed shipping contracts was deferred during the nine months ended September 30, 2009. Such revenue will be recognized in future periods either as payment for shipments in excess of guaranteed levels, or when shipping rights expire unused after a twelve-month period.

In February 2008, we acquired certain crude pipeline and tankage assets from Holly (the Crude Pipelines and Tankage Assets) that service Holly's Navajo and Woods Cross Refineries. For the nine months ended September 30, 2008, our results of operations reflect only seven months of crude pipeline and tankage operating activity due to the commencement of operations effective March 1, 2008.

Revenues

Total revenues for the nine months ended September 30, 2009 were \$115.5 million, a \$31.9 million increase compared to the nine months ended September 30, 2008. This increase was due principally to increased shipments on our pipeline systems, increased revenues attributable to our crude pipeline assets acquired in the first quarter of 2008, the effect of the July 2009 annual tariff increases on affiliate pipeline shipments and an increase in previously deferred revenue realized. Increased volumes attributable to Holly's 15,000 barrels per stream day expansion of the Navajo Refinery, including volumes shipped on our new 16-inch pipeline, contributed to a 19% net increase in affiliate pipeline shipments. Affiliate shipments for the nine months ended September 30, 2009 were impacted by the effects of reduced production during Holly's planned maintenance turnaround of its Navajo Refinery in the first quarter of 2009. Additionally, third-party refined product shipments were up for the current year-to-date period compared to last year's period, which were down as a result of limited production resulting from an explosion and fire at Alon's Big Spring refinery in the first quarter of 2008.

Revenues from our refined product pipelines were \$69.6 million, an increase of \$21.4 million compared to the nine months ended September 30, 2008. This increase was due to increased shipments on our refined product pipeline system, the effect of the July 2009 annual tariff increase on affiliate refined product shipments and a \$9.7 million increase in previously deferred revenue realized. Shipments on our refined product pipeline system increased to an average of 145.0 mbpd compared to 111.5 mbpd for the same period last year.

Revenues from our intermediate pipelines were \$11.4 million, a \$2.4 million increase compared to the nine months ended September 30, 2008. This increase was due to increased shipments on our intermediate pipeline system including volumes shipped on our new 16-inch pipeline, the effect of annual tariff increases on intermediate pipeline shipments and a \$0.7 million increase in previously deferred revenue realized. Shipments on our intermediate product pipeline system increased to an average of 64.5 mbpd compared to 58.0 mbpd for the same period last year.

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Revenues from our crude pipelines were \$21.2 million, an increase of \$5.7 million compared to the nine months ended September 30, 2008. This increase was due to the realization of revenues from crude oil shipments for a full nine-month period during the nine months ended September 30, 2009 compared to seven months of shipments during the same period last year due to the commencement of operations effective March 1, 2008 and increased shipments on our crude pipeline system. Shipments on our crude pipeline system increased to an average of 136.3 mbpd during the nine months ended September 30, 2009 compared to 132.5 mbpd for the months of March through September 2008. Revenues from terminal, tankage and loading rack fees were \$13.2 million, an increase of \$2.4 million compared to the same period last year. This increase includes \$0.5 million in revenues attributable to volumes transferred via our Tulsa Loading Racks beginning August 1, 2009. Refined products terminalled in our facilities increased to an average of 149.8 mbpd compared to 139.7 mbpd for the same period last year.

Operating Costs

Operations expense for the nine months ended September 30, 2009 increased by \$2.6 million compared to the nine months ended September 30, 2008. This increase was due principally to costs attributable to our crude pipelines acquired in February 2008 and higher throughput volumes. For the nine months ended September 30, 2009, operating costs reflect costs attributable to our crude pipeline operations for a full nine-month period compared to seven months during the same period of 2008 due to the commencement of operations effective March 1, 2008.

Depreciation and Amortization

Depreciation and amortization for the nine months ended September 30, 2009 increased by \$3.7 million compared to the nine months ended September 30, 2008. This increase was due to increased depreciation attributable to asset acquisitions and capital projects.

General and Administrative

General and administrative costs for the nine months ended September 30, 2009 increased by \$0.7 million compared to the nine months ended September 30, 2008. This increase was due principally to increased professional fees.

Equity in earnings of SLC Pipeline

The SLC Pipeline commenced pipeline operations effective March 2009. Our equity in earnings of the SLC Pipeline was \$1.3 million for the nine months ended September 30, 2009.

SLC Pipeline Acquisition Costs

We incurred a \$2.5 million finder's fee in connection with the acquisition our SLC Pipeline joint venture interest. As a result of accounting requirements effective January 1, 2009, we were required to expense rather than capitalize these direct acquisition costs.

Interest Expense

Interest expense for the nine months ended September 30, 2009 totaled \$16.2 million, an increase of \$2.0 million compared to the nine months ended September 30, 2008. This increase was due principally to interest attributable to advances from our revolving credit agreement that were used to finance asset acquisitions as well as capital projects, offset by the effects of a lower effective interest rate. Additionally for the nine months ended September 30, 2009, fair value adjustments to our interest rate swaps resulted in a \$0.3 million non-cash increase in interest expense. Excluding the effects of these fair value adjustments, our aggregate effective interest rate was 5.2% for the nine months ended September 30, 2009 compared to 5.4% for the same period last year.

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State Income Tax

State income taxes were \$0.3 million and \$0.2 million for the nine months ended September 30, 2009 and 2008, respectively.

LIQUIDITY AND CAPITAL RESOURCES

Overview

We have a \$300.0 million senior secured revolving credit agreement expiring in August 2011 (the Credit Agreement). The Credit Agreement is available to fund capital expenditures, acquisitions, and working capital and for general partnership purposes. In addition, the Credit Agreement is available to fund letters of credit up to a \$50.0 million sub-limit and to fund distributions to unitholders up to a \$20.0 million sub-limit. During the nine months ended September 30, 2009, we received advances totaling \$197.0 million that were used for our acquisitions and for capital projects and repaid \$152.0 million, resulting in \$45.0 million in net advances received. As of September 30, 2009, we had \$245.0 million outstanding under the Credit Agreement.

Our senior notes maturing March 1, 2015 are registered with the U.S. Securities and Exchange Commission (SEC) and bear interest at 6.25% (the Senior Notes). The Senior Notes are unsecured and impose certain restrictive covenants, including limitations on our ability to incur additional indebtedness, make investments, sell assets, incur certain liens, pay distributions, enter into transactions with affiliates, and enter into mergers.

In May 2009, we closed a public offering of 2,192,400 of our common units priced at \$27.80 per unit including 192,400 common units issued pursuant to the underwriters' exercise of their over-allotment option. Net proceeds of \$58.4 million were used to repay bank debt and for general partnership purposes. In addition, we received a \$1.2 million capital contribution from our general partner to maintain its 2% general partner interest.

Under our registration statement filed with the SEC using a shelf registration process, we currently have the ability to raise approximately \$940.0 million through security offerings, through one or more prospectus supplements that would describe, among other things, the specific amounts, prices and terms of any securities offered and how the proceeds would be used. Any proceeds from the sale of securities would be used for general business purposes, which may include, among other things, funding acquisitions of assets or businesses, working capital, capital expenditures, investments in subsidiaries, the retirement of existing debt and/or the repurchase of common units or other securities. We believe our current cash balances, future internally generated funds and funds available under our Credit Agreement will provide sufficient resources to meet our working capital liquidity needs for the foreseeable future.

With the current conditions in the credit and equity markets, there may be limits on our ability to issue new debt or equity financing. Additionally, due to pricing in the current debt and equity markets, we may not be able to issue new debt and equity at acceptable pricing. As a result, our ability to fund certain of our planned capital projects and other business opportunities may be limited.

In February, May and August 2009, we paid regular cash distributions of \$0.765, \$0.775 and \$0.785 on all units, an aggregate amount of \$44.4 million. Included in these distributions was \$3.8 million paid to the general partner as an incentive distribution.

Cash and cash equivalents decreased by \$1.2 million during the nine months ended September 30, 2009. The cash flows used for investing activities of \$99.0 million exceeded cash flows provided by operating and financing activities of \$44.8 million and \$53.0 million, respectively. Working capital for the nine months ended September 30, 2009 increased by \$42.8 million due principally to the reclassification of \$29.0 million in Credit Agreement advances to long-term debt. These advances were classified as short-term borrowings at December 31, 2008 and have been reclassified to long-term debt since our Credit Agreement expires in 2011.

Table of Contents***Cash Flows Operating Activities***

Cash flows from operating activities increased by \$6.7 million from \$38.1 million for the nine months ended September 30, 2008 to \$44.8 million for the nine months ended September 30, 2009. Additional cash collections of \$13.4 million from our major customers were offset by miscellaneous year-over-year changes in collections and payments.

Our major shippers are obligated to make deficiency payments to us if they do not meet their minimum volume shipping obligations. Under certain agreements with these shippers, they have the right to recapture these amounts if future volumes exceed minimum levels. For the nine months ended September 30, 2009, we received cash payments of \$6.9 million under these commitments. We billed \$13.8 million during the nine months ended September 30, 2008 related to shortfalls that subsequently expired without recapture and was recognized as revenue during the nine months ended September 30, 2009. Another \$1.6 million is included in our accounts receivable at September 30, 2009 related to shortfalls that occurred in the third quarter of 2009.

Cash Flows Investing Activities

Cash flows used for investing activities decreased by \$101.0 million from \$200.0 million for the nine months ended September 30, 2008 to \$99.0 million for the nine months ended September 30, 2009. During the nine months ended September 30, 2009, we acquired the Tulsa Loading Racks, Holly's 16-inch intermediate pipeline and our SLC Pipeline joint venture interest costing \$11.8 million, \$34.2 million and \$25.5 million, respectively. Additionally, additions to properties and equipment for the nine months ended September 30, 2009 were \$27.5 million, a decrease of \$1.5 million compared to \$29.0 million for same period last year. These additions relate principally to the expansion of our pipeline system between Artesia, New Mexico and El Paso, Texas (the South System). For the nine months ended September 30, 2008, we paid \$171.0 million in connection with our purchase of the Crude Pipelines and Tankage Assets from Holly in February 2008.

In accounting for our \$17.5 million acquisition of the Tulsa Loading Racks in August 2009, we recorded property and equipment of \$11.8 million, representing Holly's cost basis in the transferred assets since we are a controlled subsidiary of Holly and recorded the \$5.7 million excess purchase price over Holly's basis in the assets as a decrease to our partners' equity.

Cash Flows Financing Activities

Cash flows provided by financing activities decreased by \$100.7 million from \$153.7 million for the nine months ended September 30, 2008 to \$53.0 million for the nine months ended September 30, 2009. During the nine months ended September 30, 2009, we received \$197.0 million and repaid \$152.0 million in advances under the Credit Agreement. We also received \$58.4 million in proceeds and incurred \$0.3 million in costs with respect to our May 2009 equity offering. During the nine months ended September 30, 2009, we paid \$44.4 million in regular quarterly cash distributions to our general and limited partners, paid \$5.7 million in excess of Holly's basis in the Tulsa Loading Racks and paid \$0.6 million in distributions to noncontrolling interest holders in Rio Grande. Additionally during 2009, we received a \$1.2 million capital contribution from our general partner and paid \$0.6 million for the purchase of common units for recipients of our restricted unit incentive grants. During the nine months ended September 30, 2008, we received \$221.0 million and repaid \$26.0 million in advances under the Credit Agreement, received \$0.1 million from the issuance of our common units and incurred \$0.7 million in deferred financing costs in connection with the amendment to the Credit Agreement. We also paid \$38.9 million in regular quarterly cash distributions to our general partner and limited partners and paid \$1.2 million in distributions to noncontrolling interest holders in Rio Grande. Additionally during 2008, we received a \$0.2 million capital contribution from our general partner and paid \$0.8 million for the purchase of common units for recipients of our restricted unit incentive grants.

Table of Contents***Capital Requirements***

Our pipeline and terminalling operations are capital intensive, requiring investments to maintain, expand, upgrade or enhance existing operations and to meet environmental and operational regulations. Our capital requirements consist of maintenance capital expenditures and expansion capital expenditures. Repair and maintenance expenses associated with existing assets that are minor in nature and do not extend the useful life of existing assets are charged to operating expenses as incurred.

Each year the Holly Logistic Services, L.L.C. (HLS) board of directors approves our annual capital budget, which specifies capital projects that our management is authorized to undertake. Additionally, at times when conditions warrant or as new opportunities arise, special projects may be approved. The funds allocated for a particular capital project may be expended over a period in excess of a year, depending on the time required to complete the project. Therefore, our planned capital expenditures for a given year consist of expenditures approved for capital projects included in the current year's capital budget as well as, in certain cases, expenditures approved for capital projects in capital budgets for prior years. The 2009 capital budget is comprised of \$3.7 million for maintenance capital expenditures and \$2.2 million for expansion capital expenditures.

We have an agreement with Holly under which we have agreed to expand the South System. The South System expansion includes replacing 85 miles of 8-inch pipe with 12-inch pipe, adding 150,000 barrels of refined product storage at our El Paso Terminal, improving existing pumps, adding a tie-in to the Kinder Morgan pipeline to Tucson and Phoenix, Arizona, and making related modifications. The cost of this project is estimated to be \$52.0 million. Construction of the South System pipe replacement and storage tankage is complete and improvements to Kinder Morgan's El Paso pump station are expected to be completed by December 2009.

On June 1, 2009, we acquired a newly constructed 16-inch intermediate pipeline from Holly for \$34.2 million. The pipeline runs 65 miles from the Navajo Refinery's crude oil distillation and vacuum facilities in Lovington, New Mexico to its petroleum refinery located in Artesia, New Mexico. This pipeline was placed in service effective June 1, 2009 and operates as a component of our intermediate pipeline system that services Holly's Navajo Refinery.

On August 1, 2009, we acquired the Tulsa Loading Racks from Holly located at Holly's Tulsa Refinery for \$17.5 million. The racks load refined products produced at the Tulsa Refinery onto rail cars and/or tanker trucks for delivery to surrounding markets.

In March 2009, we acquired a 25% joint venture interest in a new 95-mile intrastate pipeline system, the SLC Pipeline, jointly owned by Plains and us. The SLC Pipeline allows various refiners in the Salt Lake City area, including Holly's Woods Cross Refinery, to ship crude oil into the Salt Lake City area from the Utah terminus of the Frontier Pipeline as well as crude oil flowing from Wyoming and Utah via Plains' Rocky Mountain Pipeline. The total cost of our investment in the SLC Pipeline was \$28.0 million, consisting of the capitalized \$25.5 million joint venture contribution and the \$2.5 million finder's fee paid to Holly that was expensed as acquisition costs.

We have an option agreement with Holly, granting us an option to purchase Holly's 75% equity interest in a joint venture pipeline currently under construction. The pipeline will be capable of transporting refined petroleum products from Salt Lake City, Utah to Las Vegas, Nevada (the UNEV Pipeline). Under this agreement, we have an option to purchase Holly's equity interests in the UNEV Pipeline, effective for a 180-day period commencing when the UNEV Pipeline becomes operational, at a purchase price equal to Holly's investment in the joint venture pipeline, plus interest at 7% per annum. The initial capacity of the pipeline will be 62,000 bpd, with the capacity for further expansion to 120,000 bpd. The total cost of the pipeline project including terminals is expected to be \$300.0 million. Holly's share of this cost is \$225.0 million. Holly expects the project to be ready to commence operations in the fall of 2010.

Holly is currently working on a project to deliver additional crude oils to its Navajo Refinery, including a 70-mile pipeline from Centurion Pipeline L.P.'s Slaughter Station in west Texas to Lovington, New Mexico. The cost of the project is expected to be \$39.5 million and construction is currently expected to be completed and the project to become fully operational by November 2009. Additionally, Holly recently

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completed a 37-mile 8-inch crude oil pipeline from the Beeson Station to Lovington, New Mexico at a cost of approximately \$11.0 million. Under provisions of the Omnibus Agreement, we will have an option to purchase Holly's investment in these projects at a purchase price to be negotiated with Holly.

We are currently working on a capital improvement project that will provide increased flexibility and capacity to our intermediate pipelines enabling us to accommodate increased volumes following Holly's Navajo Refinery capacity expansion. This project is expected to be completed by November 2009 at an estimated cost of \$7.0 million.

During the first quarter of 2009, we completed the conversion of an existing 12-mile crude oil pipeline to a natural gas pipeline at a cost of \$1.1 million. This pipeline is operational and delivering natural gas to Holly's Navajo Refinery.

On October 20, 2009, we announced an agreement with Sinclair Oil Company (Sinclair) to purchase certain logistics and storage assets consisting of storage tanks having approximately 1.4 million barrels of storage capacity, loading racks and a refined product delivery pipeline at Sinclair's refinery located in Tulsa, Oklahoma. Separately Holly, also a party to the agreement, announced an agreement to purchase the refining assets at Sinclair's Tulsa refinery. In conjunction with these transactions, we expect to enter into a long-term agreement with Holly to provide certain storage, loading, delivery and receiving services associated with the new assets.

We expect that our currently planned expenditures for sustaining and maintenance capital as well as expenditures for acquisitions and capital development projects such as the UNEV Pipeline, Sinclair logistic and storage assets and Holly crude oil pipeline projects described above, will be funded with existing cash generated by operations, the sale of additional limited partner units, the issuance of debt securities and advances under our \$300 million Credit Agreement maturing August 2011, or a combination thereof. With the uncertain conditions in the credit and equity markets during 2009, there may be limits on our ability to issue new debt or equity financing. Additionally, due to pricing movements in the current debt and equity markets, we may not be able to issue new debt and equity securities at acceptable pricing. Without additional capital beyond amounts available under the Credit Agreement, our ability to fund some of these capital projects may be limited, especially the UNEV Pipeline and Holly's crude oil pipeline projects. We are not obligated to purchase these assets nor are we subject to any fees or penalties if HLS' board of directors decide not to proceed with any of these opportunities.

Credit Agreement

We have a \$300.0 million senior secured revolving credit agreement expiring in August 2011. The Credit Agreement is available to fund capital expenditures, acquisitions, and working capital and for general partnership purposes. In addition, the Credit Agreement is available to fund letters of credit up to a \$50.0 million sub-limit and to fund distributions to unitholders up to a \$20.0 million sub-limit. Advances under the Credit Agreement that are designated for working capital are classified as short-term liabilities. Other advances under the Credit Agreement, including advances used for the interim financing of capital projects, are classified as long-term liabilities. During the nine months ended September 30, 2009, we received advances totaling \$197.0 million that were used as interim financing for our acquisitions and for capital projects and repaid \$152.0 million, resulting in \$45.0 million in net advances received. As of September 30, 2009, we had \$245.0 million outstanding under the Credit Agreement.

Our obligations under the Credit Agreement are collateralized by substantially all of our assets. Indebtedness under the Credit Agreement is recourse to HEP Logistics Holdings, L.P., our general partner, and guaranteed by our wholly-owned subsidiaries. Any recourse to HEP Logistics Holdings, L.P. would be limited to the extent of its assets, which other than its investment in us, are not significant.

We may prepay all loans at any time without penalty, except for payment of certain breakage and related costs. We are required to reduce all working capital borrowings under the Credit Agreement to zero for a period of at least 15 consecutive days in each twelve-month period prior to the maturity date of the agreement. As of September 30, 2009, we had no working capital borrowings.

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Indebtedness under the Credit Agreement bears interest, at our option, at either (a) the reference rate as announced by the administrative agent plus an applicable margin (ranging from 0.25% to 1.50%) or (b) at a rate equal to the London Interbank Offered Rate (LIBOR) plus an applicable margin (ranging from 1.00% to 2.50%). In each case, the applicable margin is based upon the ratio of our funded debt (as defined in the agreement) to EBITDA (earnings before interest, taxes, depreciation and amortization, as defined in the agreement). At September 30, 2009, we were subject to an applicable margin of 1.75%. We incur a commitment fee on the unused portion of the Credit Agreement at a rate ranging from 0.20% to 0.50% based upon the ratio of our funded debt to EBITDA for the four most recently completed fiscal quarters. At September 30, 2009, we are subject to a 0.30% commitment fee on the \$55.0 million unused portion of the Credit Agreement. The agreement expires in August 2011. At that time, the agreement will terminate and all outstanding amounts thereunder will become due and payable.

The Credit Agreement imposes certain requirements on us, including: a prohibition against distribution to unitholders if, before or after the distribution, a potential default or an event of default as defined in the agreement would occur; limitations on our ability to incur debt, make loans, acquire other companies, change the nature of our business, enter a merger or consolidation, or sell assets; and covenants that require maintenance of a specified EBITDA to interest expense ratio and debt to EBITDA ratio. If an event of default exists under the agreement, the lenders will be able to accelerate the maturity of the debt and exercise other rights and remedies.

Additionally, the Credit Agreement contains certain provisions whereby the lenders may accelerate payment of outstanding debt under certain circumstances.

Senior Notes Due 2015

Our Senior Notes maturing March 1, 2015 are registered with the SEC and bear interest at 6.25%. The Senior Notes are unsecured and impose certain restrictive covenants, including limitations on our ability to incur additional indebtedness, make investments, sell assets, incur certain liens, pay distributions, enter into transactions with affiliates, and enter into mergers. At any time when the Senior Notes are rated investment grade by both Moody's and Standard & Poor's and no default or event of default exists, we will not be subject to many of the foregoing covenants. Additionally, we have certain redemption rights under the Senior Notes.

Indebtedness under the Senior Notes is recourse to HEP Logistics Holdings, L.P., our general partner, and guaranteed by our wholly-owned subsidiaries. Any recourse to HEP Logistics Holdings, L.P. would be limited to the extent of its assets, which other than its investment in us, are not significant.

The carrying amounts of our long-term debt are as follows:

	September 30, 2009	December 31, 2008
	(In thousands)	
Credit Agreement	\$ 245,000	\$ 200,000
Senior Notes		
Principal	185,000	185,000
Unamortized discount	(2,058)	(2,344)
Unamortized premium de-designated fair value hedge	1,877	2,137
	184,819	184,793
Total debt	429,819	384,793
Less net short-term borrowings under credit agreement ⁽¹⁾		29,000
Total long-term debt ⁽¹⁾	\$ 429,819	\$ 355,793

- (1) We are currently classifying all borrowings under the Credit Agreement as long-term. At December 31, 2008, we classified certain of our Credit Agreement borrowings as short-term.

See Risk Management for a discussion of our interest rate swaps.

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Contractual Obligations

During the nine months ended September 30, 2009, we received net advances of \$45.0 million resulting in \$245.0 million of outstanding principal under the Credit Agreement at September 30, 2009. There were no other significant changes to our long-term contractual obligations during this period.

Impact of Inflation

Inflation in the United States has been relatively low in recent years and did not have a material impact on our results of operations for the nine months ended September 30, 2009 and 2008.

A substantial majority of our revenues are generated under long-term contracts that include the right to increase our rates and minimum revenue guarantees annually for increases in the PPI. Historically, the PPI has increased an average of 4.3% annually over the past 5 calendar years.

Environmental Matters

Our operation of pipelines, terminals, and associated facilities in connection with the storage and transportation of refined products and crude oil is subject to stringent and complex federal, state, and local laws and regulations governing the discharge of materials into the environment, or otherwise relating to the protection of the environment. As with the industry generally, compliance with existing and anticipated laws and regulations increases our overall cost of business, including our capital costs to construct, maintain, and upgrade equipment and facilities. While these laws and regulations affect our maintenance capital expenditures and net income, we believe that they do not affect our competitive position in that the operations of our competitors are similarly affected. We believe that our operations are in substantial compliance with applicable environmental laws and regulations. However, these laws and regulations, and the interpretation or enforcement thereof, are subject to frequent change by regulatory authorities, and we are unable to predict the ongoing cost to us of complying with these laws and regulations or the future impact of these laws and regulations on our operations. Violation of environmental laws, regulations, and permits can result in the imposition of significant administrative, civil and criminal penalties, injunctions, and construction bans or delays. A discharge of hydrocarbons or hazardous substances into the environment could, to the extent the event is not insured, subject us to substantial expense, including both the cost to comply with applicable laws and regulations and claims made by employees, neighboring landowners and other third parties for personal injury and property damage. Under the Omnibus Agreement, Holly has also agreed to indemnify us up to certain aggregate amounts for any environmental noncompliance and remediation liabilities associated with assets transferred to us and occurring or existing prior to the date of such transfers. The Omnibus Agreement provides environmental indemnification of up to \$15.0 million through 2014 for the assets transferred to us at the time of our initial public offering in 2004, plus an additional \$2.5 million through 2015 for the intermediate pipelines acquired in July 2005 and up to \$7.5 million through 2023 for the Crude Pipelines and Tankage Assets acquired in February 2008.

Additionally, we have an environmental agreement with Alon with respect to pre-closing environmental costs and liabilities relating to the pipelines and terminals acquired from Alon in 2005, under which Alon will indemnify us through 2015, subject to a \$100,000 deductible and a \$20.0 million maximum liability cap.

There are environmental remediation projects that are currently underway relating to certain assets purchased from Holly Corporation. These remediation projects, including assessment and monitoring activities are covered by the environmental indemnification discussed above and represent liabilities of Holly Corporation.

Table of Contents**CRITICAL ACCOUNTING POLICIES**

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with U.S. GAAP. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities as of the date of the financial statements. Actual results may differ from these estimates under different assumptions or conditions.

Our significant accounting policies are described in Item 7. Management's Discussion and Analysis of Financial Condition and Operations Critical Accounting Policies in our Annual Report on Form 10-K for the year ended December 31, 2008. Certain critical accounting policies that materially affect the amounts recorded in our consolidated financial statements include revenue recognition, assessing the possible impairment of certain long-lived assets and assessing contingent liabilities for probable losses. There have been no changes to these policies in 2009. We consider these policies to be the most critical to understanding the judgments that are involved and the uncertainties that could impact our results of operations, financial condition and cash flows.

Recent Accounting Pronouncements*Accounting Standards Codification*

In June 2009, the Financial Accounting Standards Board (FASB) issued its Accounting Standards Codification (ASC), codifying all previous sources of accounting principles into a single source of authoritative, nongovernmental U.S. GAAP. Although the ASC supersedes all previous levels of authoritative accounting standards, it did not affect accounting principles under U.S. GAAP. We adopted the codification effective September 30, 2009.

Subsequent Events

In May 2009, the FASB issued accounting standards under ASC Topic Subsequent Events (previously Statement of Financial Accounting Standard (SFAS) No. 165) which establish general standards for accounting and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. We adopted these standards effective June 30, 2009. Although these standards require disclosure of the date through which we have evaluated subsequent events, it did not affect our accounting and disclosure policies with respect to subsequent events.

Interim Disclosures about Fair Value of Financial Instruments

In April 2009, the FASB issued accounting standards under ASC Topic Financial Instruments (previously FASB Staff Position (FSP) SFAS No. 107-1 and Accounting Principles Board (APB) No. 28-1) which extend the annual financial statement disclosure requirements for financial instruments to interim reporting periods of publicly traded companies. We adopted these standards effective June 30, 2009. See Note 3 for disclosure of our financial instruments.

Noncontrolling Interests in Consolidated Financial Statements

Accounting standards under ASC Topic Noncontrolling Interest in a Subsidiary (previously SFAS No. 160) became effective January 1, 2009, which change the classification of noncontrolling interests, also referred to as minority interests, in the consolidated financial statements. As a result, all previous references to minority interest within this document have been replaced with noncontrolling interest. Additionally, net income attributable to the noncontrolling interest in our Rio Grande subsidiary is now presented as an adjustment to net income to arrive at Net income attributable to Holly Energy Partners, L.P. in our Consolidated Statements of Income. Prior to our adoption of these standards, this amount was presented as Minority interest in Rio Grande, a non-operating expense item before Income before income taxes. Furthermore, equity attributable to noncontrolling interests in our Rio Grande subsidiary is now presented as a separate component of total equity in our Consolidated Financial Statements. We have applied these standards on a retrospective basis. While this presentation differs from previous U.S. GAAP requirements, it did not affect our net income and equity attributable to HEP.

Table of Contents*Business Combinations*

Accounting standards under ASC Topic Business Combinations (previously SFAS 141 No. (R)) became effective January 1, 2009, which establish principles and requirements for how an acquirer accounts for a business combination. It also requires that acquisition-related transaction and restructuring costs be expensed rather than be capitalized as part of the cost of an acquired business. Accordingly, we were required to expense the \$2.5 million finder's fee related to the acquisition of our SLC Pipeline joint venture interest.

Disclosures about Derivative Instruments and Hedging Activities

Accounting standards under ASC Topic Derivatives and Hedging (previously SFAS No. 161) became effective January 1, 2009, which amend and expand disclosure requirements to include disclosure of the objectives and strategies related to an entity's use of derivative instruments, disclosure of how an entity accounts for its derivative instruments and disclosure of the financial impact, including the effect on cash flows associated with derivative activity. See Risk Management below for disclosure of our derivative instruments and hedging activity.

Earnings per Share - Master Limited Partnerships

Accounting standards under ASC Topic Earnings Per Share (previously Emerging Issues Task Force (EITF) Issue No. 07-04) became effective January 1, 2009, which prescribe the application of the two-class method in computing earnings per unit to reflect a master limited partnership's contractual obligation to make distributions to the general partner, limited partners and incentive distribution rights holders. As a result, quarterly earnings allocations to the general partner now include incentive distributions that were declared subsequent to quarter end. Prior to our adoption of these standards, our general partner earnings allocations included incentive distributions that were declared during each quarter. We have applied these standards on a retrospective basis. The adoption of these standards resulted in a decrease in our limited partners' interest in net income attributable to Holly Energy Partners, L.P. for the three and nine months ended September 30, 2008, reducing earnings per limited partner unit by \$.01 to \$0.34 and \$0.95 for the three and nine months ended September 30, 2008, respectively.

Participating Securities - Instruments Granted in Share-Based Transactions

Accounting standards under ASC Topic Earnings Per Share (previously FSP No. 03-6-1) became effective January 1, 2009, which provide guidance in determining whether unvested instruments granted under share-based payment transactions are participating securities and, therefore, should be included in earnings per share calculations under the two-class method. The adoption of these standards did not have a material impact on our financial condition, results of operations and cash flows.

RISK MANAGEMENT

We use interest rate derivatives to manage our exposure to interest rate risk. As of September 30, 2009, we have three interest rate swap contracts.

We have an interest rate swap that hedges our exposure to the cash flow risk caused by the effects of LIBOR changes on the \$171.0 million Credit Agreement advance that we used to finance our purchase of the Crude Pipelines and Tankage Assets in February 2008. This interest rate swap effectively converts our \$171.0 million LIBOR based debt to fixed rate debt having an interest rate of 3.74% plus an applicable margin, currently 1.75%, which equaled an effective interest rate of 5.49% as of September 30, 2009. The maturity date of this swap contract is February 28, 2013.

We have designated this interest rate swap as a cash flow hedge. Based on our assessment of effectiveness using the change in variable cash flows method, we have determined that this interest rate swap is effective in offsetting the variability in interest payments on our \$171.0 million variable rate debt resulting from changes in LIBOR. Under hedge accounting, we adjust our cash flow hedge on a quarterly basis to its fair value with the offsetting fair value adjustment to accumulated other comprehensive income. Also on a quarterly basis, we measure hedge effectiveness by comparing the present value of the cumulative change in the expected future interest to be paid or received on the variable leg of our swap against the expected future interest payments on our \$171.0 million variable rate debt. Any ineffectiveness is reclassified from accumulated other comprehensive income to interest expense. As of September 30, 2009, we had no ineffectiveness on our cash flow hedge.

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We also have an interest rate swap contract that effectively converts interest expense associated with \$60.0 million of our 6.25% Senior Notes from a fixed to a variable rate (Variable Rate Swap). Under this swap contract, interest on the \$60.0 million notional amount is computed using the three-month LIBOR plus a spread of 1.1575%, which equaled an effective interest rate of 1.52% as of September 30, 2009. The maturity date of this swap contract is March 1, 2015, matching the maturity of the Senior Notes.

In October 2008, we entered into an additional interest rate swap contract, effective December 1, 2008, that effectively unwinds the effects of the Variable Rate Swap discussed above, converting \$60.0 million of our hedged long-term debt back to fixed rate debt (Fixed Rate Swap). Under the Fixed Rate Swap, interest on a notional amount of \$60.0 million is computed at a fixed rate of 3.59% versus three-month LIBOR which when added to the 1.1575% spread on the Variable Rate Swap results in an effective fixed interest rate of 4.75%. The maturity date of this swap contract is December 1, 2013.

Prior to the execution of our Fixed Rate Swap, the Variable Rate Swap was designated as a fair value hedge of \$60.0 million in outstanding principal under the Senior Notes. We designated this hedge in October 2008. At this time, the carrying balance of our Senior Notes included a \$2.2 million premium due to the application of hedge accounting until the designation date. This premium is being amortized as a reduction to interest expense over the remaining term of the Variable Rate Swap.

Our interest rate swaps not having a hedge designation are measured quarterly at fair value either as an asset or a liability in our consolidated balance sheets with the offsetting fair value adjustment to interest expense. For the three and nine months ended September 30, 2009, we recognized an increase of \$0.9 million and \$0.3 million, respectively, in interest expense as a result of fair value adjustments to our interest rate swaps.

We record interest expense equal to the variable rate payments under the swaps. Receipts under the swap agreements are recorded as a reduction of interest expense.

Additional information on our interest rate swaps as of September 30, 2009 is as follows:

Interest Rate Swaps	Balance Sheet Location	Fair Value (In thousands)	Location of Offsetting Balance	Offsetting Amount
Asset				
Fixed-to-variable interest rate swap -\$60 million of 6.25% Senior Notes	Other assets	\$ 2,658	Long-term debt HEP partners equity Interest expense	\$ (1,877) (1,942) ⁽¹⁾ 1,161 ⁽²⁾
		\$ 2,658		\$ (2,658)
Liability				
Cash flow hedge - \$171 million LIBOR based debt	Other long-term liabilities	\$ (10,182)	Accumulated other comprehensive loss	\$ 10,182
Variable-to-fixed interest rate swap - \$60 million	Other long-term liabilities	(3,044)	HEP partners equity Interest expense	4,166 ⁽¹⁾ (1,122)
		\$ (13,226)		\$ 13,226

(1) Represents prior year charges to interest expense.

- (2) Net of
amortization of
premium
attributable to
designated
hedge.

We review publicly available information on our counterparties in order to review and monitor their financial stability and assess their ongoing ability to honor their commitments under the interest rate swap contracts. These counterparties consist of large financial institutions. Furthermore, we have not experienced, nor do we expect to experience, any difficulty in the counterparties honoring their respective commitments.

The market risk inherent in our debt instruments and positions is the potential change arising from increases or decreases in interest rates as discussed below.

At September 30, 2009, we had an outstanding principal balance on our 6.25% Senior Notes of \$185.0 million. By means of our interest rate swap contracts, we have effectively converted the 6.25% fixed rate on \$60.0 million of the Senior Notes to a fixed rate of 4.75%. A change in interest rates would generally

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affect the fair value of the debt, but not our earnings or cash flows. At September 30, 2009, the fair value of our Senior Notes was \$169.3 million. We estimate a hypothetical 10% change in the yield-to-maturity applicable to the Senior Notes at September 30, 2009 would result in a change of approximately \$6.2 million in the fair value of the debt.

At September 30, 2009, our cash and cash equivalents included highly liquid investments with a maturity of three months or less at the time of purchase. Due to the short-term nature of our cash and cash equivalents, a hypothetical 10% increase in interest rates would not have a material effect on the fair market value of our portfolio. Since we have the ability to liquidate this portfolio, we do not expect our operating results or cash flows to be materially affected to any significant degree by the effect of a sudden change in market interest rates on our investment portfolio.

Our operations are subject to normal hazards of operations, including fire, explosion and weather-related perils. We maintain various insurance coverages, including business interruption insurance, subject to certain deductibles. We are not fully insured against certain risks because such risks are not fully insurable, coverage is unavailable, or premium costs, in our judgment, do not justify such expenditures.

We have a risk management oversight committee that is made up of members from our senior management. This committee monitors our risk environment and provides direction for activities to mitigate, to an acceptable level, identified risks that may adversely affect the achievement of our goals.

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Item 3. Quantitative and Qualitative Disclosures About Market Risks

Market risk is the risk of loss arising from adverse changes in market rates and prices. See Risk Management under Management's Discussion and Analysis of Financial Condition and Results of Operations for a discussion of market risk exposures that we have with respect to our cash and cash equivalents and long-term debt. We utilize derivative instruments to hedge our interest rate exposure, also discussed under Risk Management.

Since we do not own products shipped on our pipelines or terminalled at our terminal facilities we do not have market risks associated with commodity prices.

Item 4. Controls and Procedures

(a) Evaluation of disclosure controls and procedures

Our principal executive officer and principal financial officer have evaluated, as required by Rule 13a-15(b) under the Securities Exchange Act of 1934 (the Exchange Act), our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this quarterly report on Form 10-Q. Our disclosure controls and procedures are designed to provide reasonable assurance that the information we are required to disclose in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure and is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Based upon the evaluation, our principal executive officer and principal financial officer have concluded that our disclosure controls and procedures were effective as of September 30, 2009.

(b) Changes in internal control over financial reporting

There have been no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) that occurred during our last fiscal quarter that have been materially affected or are reasonably likely to materially affect our internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

We are a party to various legal and regulatory proceedings, none of which we believe will have a material adverse impact on our financial condition, results of operations or cash flows.

Item 6. Exhibits

- 10.1 Asset Purchase Agreement, dated as of August 1, 2009, between Holly Refining & Marketing Tulsa LLC and HEP Tulsa LLC (incorporated by reference to Exhibit 10.1 of Registrant's Form 8-K Current Report dated August 6, 2009, File No. 1-32225).
- 10.2 Second Amended and Restated Omnibus Agreement, dated as of August 1, 2009, by and among Holly Corporation, Holly Energy Partners, L.P., and certain of their respective subsidiaries (incorporated by reference to Exhibit 10.2 of Registrant's Form 8-K Current Report dated August 6, 2009, File No. 1-32225).
- 10.3 Tulsa Equipment and Throughput Agreement, dated as of August 1, 2009, between Holly Refining & Marketing Tulsa LLC and HEP Tulsa LLC (incorporated by reference to Exhibit 10.3 of Registrant's Form 8-K Current Report dated August 6, 2009, File No. 1-32225).
- 10.4 Tulsa Purchase Option Agreement, dated as of August 1, 2009, between Holly Refining & Marketing Tulsa LLC and HEP Tulsa LLC (incorporated by reference to Exhibit 10.4 of Registrant's Form 8-K Current Report dated August 6, 2009, File No. 1-32225).
- 12.1* Computation of Ratio of Earnings to Fixed Charges.
- 31.1* Certification of Chief Executive Officer under Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2* Certification of Chief Financial Officer under Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1** Certification of Chief Executive Officer under Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2** Certification of Chief Financial Officer under Section 906 of the Sarbanes-Oxley Act of 2002.

* Filed herewith

** Furnished
herewith

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HOLLY ENERGY PARTNERS, L.P.

SIGNATURES

Pursuant to the requirements of the Securities and Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

HOLLY ENERGY PARTNERS, L.P.

(Registrant)

By: HEP LOGISTICS HOLDINGS, L.P.
its General Partner

By: HOLLY LOGISTIC SERVICES,
L.L.C.
its General Partner

Date: October 30, 2009

/s/ Bruce R. Shaw
Bruce R. Shaw
Senior Vice President and
Chief Financial Officer
(Principal Financial Officer)

/s/ Scott C. Surplus
Scott C. Surplus
Vice President and Controller
(Principal Accounting Officer)

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