UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2011

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from __________ to _________

Commission File Number 001-33503

BLUEKNIGHT ENERGY PARTNERS, L.P.
(Exact name of registrant as specified in its charter)

Delaware	20-8536826
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

Two Warren Place
6120 South Yale Avenue, Suite 500
Tulsa, Oklahoma 74136
(Address of principal executive offices, zip code)

Registrant's telephone number, including area code: (918) 237-4000

(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 x No o

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 x No o

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 the definitions of “large accelerated filer”, “accelerated filer”, and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o Accelerated filer x

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

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

As of November 7, 2011, there were 21,538,462 Series A Preferred Units and 22,657,638 common units outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

BLUEKNIGHT ENERGY PARTNERS, L.P.
CONSOLIDATED BALANCE SHEETS
(in thousands, except per unit data)

	As of December 31, 2010	As of September 30, 2011
		(unaudited)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 4,840	$ 1,010
Accounts receivable, net of allowance for doubtful accounts of $429 for both dates	8,824	12,980
Receivables from related parties, net of allowance for doubtful accounts of $0 for both dates	1,912	2,843
Insurance recovery receivable	13,000	13,000
Prepaid insurance	1,413	2,525
Other current assets	2,147	1,673
Total current assets	32,136	34,031
Property, plant and equipment, net of accumulated depreciation of $119,735 and $132,052 at December 31, 2010 and September 30, 2011, respectively	274,069	271,624
Goodwill	7,083	7,216
Debt issuance costs, net	6,675	5,494
Intangibles and other assets, net	3,875	2,410
Total assets	$ 323,838	$ 320,775
LIABILITIES AND PARTNERS’ CAPITAL (DEFICIT)		
Current liabilities:		
Accounts payable	$ 8,829	$ 8,057
Accrued loss contingency (see Note 13)	20,200	19,976
Accrued interest payable	357	171
Accrued interest payable to related parties	1,214	5,187
Accrued property taxes payable	2,254	2,990
Unearned revenue	3,506	3,911
Unearned revenue with related parties	2,154	—
Accrued payroll	4,130	4,918
Other accrued liabilities	3,709	3,648
Convertible Debentures (see Note 5)	31,725	44,932
Fair value of derivative embedded within Convertible Debentures	27,550	—
Fair value of rights offering liability	10,441	8,603
Current portion of long-term payable to related parties	1,183	1,580
Total current liabilities	117,252	103,973
Long-term payable to related parties	4,317	3,112
Other long-term liabilities	150	150
Long-term debt (including $15.0 million with related parties for both dates)	239,862	226,000
Commitments and contingencies (Notes 5 and 13)		
Partners’ capital (deficit):		

Series A Preferred Units (21,538,462 units issued and outstanding for both dates)		91,376		124,437
Common unitholders (21,890,224 units issued and outstanding for both dates)		478,575		475,990
Subordinated unitholders (12,570,504 and zero units issued and outstanding at December 31, 2010 and September 30, 2011, respectively)		(286,264)		—
General partner interest (2.0% and 3.0% interest at December 31, 2010 and September 30, 2011, respectively, with 1,127,755 general partner units outstanding for both dates)		(321,430)		(612,887)
Total Partners' deficit		(37,743)		(12,460)
Total liabilities and Partners' deficit	$	323,838	$	320,775

See accompanying notes to unaudited consolidated financial statements.

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BLUEKNIGHT ENERGY PARTNERS, L.P.
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per unit data)

	Three Months Ended September 30, 2010	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2011
	(unaudited)			
Service revenue:				
Third party revenue	$ 31,113	$ 35,124	$ 97,895	$ 99,748
Related party revenue	6,943	11,387	15,637	31,377
Total revenue	38,056	46,511	113,532	131,125
Expenses:				
Operating	23,441	27,617	73,442	85,726
General and administrative	3,883	4,679	11,037	14,065
Total expenses	27,324	32,296	84,479	99,791
Operating income	10,732	14,215	29,053	31,334
Other (income) expenses:				
Interest expense	13,530	9,120	39,502	27,284
Change in fair value of embedded derivative within convertible debt	—	(15,358)	—	(20,224)
Change in fair value of rights offering liability	—	(8,224)	—	(1,838)
Income (loss) before income taxes	(2,798)	28,677	(10,449)	26,112
Provision for income taxes	50	72	151	219
Net income (loss)	$ (2,848)	$ 28,605	$ (10,600)	$ 25,893
Allocation of net income (loss) for calculation of earnings per unit:				
General partner interest in net income (loss)	$ (57)	$ 643	$ (209)	$ 754
Preferred interest in net income	$ —	$ 2,975	$ —	$ 11,124
Beneficial conversion feature attributable to preferred units	$ —	$ 11,141	$ —	$ 33,061
Income (loss) available to common and subordinated unitholders	$ (2,791)	$ 13,846	$ (10,391)	$ (19,046)
Basic and diluted net income (loss) per common unit	$ (0.08)	$ 0.38	$ (0.30)	$ (0.56)
Basic and diluted net income (loss) per subordinated unit	$ (0.08)	$ 0.42	$ (0.30)	$ (0.52)
Weighted average common units outstanding - basic and diluted	21,728	21,890	21,728	21,890
Weighted average subordinated units outstanding - basic and diluted	12,571	10,248	12,571	11,788

See accompanying notes to unaudited consolidated financial statements.

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BLUEKNIGHT ENERGY PARTNERS, L.P.

CONSOLIDATED STATEMENTS OF CHANGES IN PARTNERS' CAPITAL (DEFICIT)
(in thousands)

	Common Unitholders	Subordinated Unitholders	Series A Preferred Unitholders	General Partner Interest	Total Partners' Deficit
			(unaudited)		
Balance, December 31, 2010	$ 478,575	$ (286,264)	$ 91,376	$ (321,430)	$ (37,743)
Net income	11,540	5,674	8,149	530	25,893
Equity-based incentive compensation	246	124	—	7	377
Amortization of beneficial conversion feature of Preferred units	(21,697)	(11,364)	33,061	—	—
Distributions	—	—	(8,149)	(164)	(8,313)
Debt conversion option classified as equity	7,326	—	—	—	7,326
Contribution and cancellation of subordinated units	—	291,830	—	(291,830)	—
Balance, September 30, 2011	$ 475,990	$ —	$ 124,437	$ (612,887)	$ (12,460)

See accompanying notes to unaudited consolidated financial statements.

BLUEKNIGHT ENERGY PARTNERS, L.P.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2011
	(unaudited)	
Cash flows from operating activities:		
Net income (loss)	$ (10,600)	$ 25,893
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	16,228	17,066
Amortization and write-off of debt issuance costs	3,640	1,461
Amortization of subordinated debenture discount	—	13,207
Decrease in fair value of embedded derivative within convertible debt	—	(20,224)
Decrease in fair value of rights offering liability	—	(1,838)
Asset impairment charge	779	—
Gain on sale of assets	(103)	(1,852)
Equity-based incentive compensation	27	377
Changes in assets and liabilities		
Decrease (increase) in accounts receivable	138	(4,156)
Decrease (increase) in receivables from related parties	130	(931)
Decrease in prepaid insurance	1,020	450
Decrease in other current assets	1,076	474
Decrease (increase) in other assets	(276)	1,118
Decrease in accounts payable	(1,169)	(2,036)
Increase (decrease) in accrued interest payable	6,377	(186)
Increase in accrued interest payable to related parties	61	3,973
Increase (decrease) in accrued property taxes	(570)	736
Increase (decrease) in unearned revenue	(2,649)	405
Increase (decrease) in unearned revenue from related parties	955	(2,154)
Increase in accrued payroll	588	788
Increase (decrease) in other accrued liabilities	832	(795)
Net cash provided by operating activities	16,484	31,776
Cash flows from investing activities:		
Acquisitions	—	(133)
Capital expenditures	(11,279)	(13,686)
Proceeds from sale of assets	1,628	2,244
Net cash used in investing activities	(9,651)	(11,575)
Cash flows from financing activities:		
Payment on insurance premium financing agreement	(174)	(768)
Debt issuance costs	(1,119)	(280)
Payments on capital lease obligations	(248)	—
Borrowings from related party	5,500	—
Payments on long-term payable to related party	—	(808)
Borrowings under credit facility	40,700	6,000
Payments under credit facility	(54,971)	(19,862)
Distributions	—	(8,313)
Net cash used in financing activities	(10,312)	(24,031)

Net decrease in cash and cash equivalents		(3,479)		(3,830)
Cash and cash equivalents at beginning of period		5,548		4,840
Cash and cash equivalents at end of period	$	2,069	$	1,010
Supplemental disclosure of cash flow information:				
Increase in accounts payable related to purchase of property, plant and equipment	$	189	$	1,264
Increase in accrued liabilities related to insurance premium financing agreement	$	407	$	1,278

See accompanying notes to unaudited consolidated financial statements.

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BLUEKNIGHT ENERGY PARTNERS, L.P.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. ORGANIZATION AND NATURE OF BUSINESS

Blueknight Energy Partners, L.P. (formerly SemGroup Energy Partners, L.P.) and subsidiaries (the "Partnership") is a publicly traded master limited partnership with operations in twenty-three states. The Partnership provides integrated terminalling, storage, processing, gathering and transportation services for companies engaged in the production, distribution and marketing of crude oil and asphalt products. The Partnership manages its operations through four operating segments: (i) crude oil terminalling and storage services, (ii) crude oil pipeline services, (iii) crude oil trucking and producer field services and (iv) asphalt services. The Partnership's common units, which represent limited partnership interests in the Partnership, are listed on the NASDAQ Global Market. The Partnership was formed in February of 2007 as a Delaware master limited partnership initially to own, operate and develop a diversified portfolio of complementary midstream energy assets.

2. BASIS OF PRESENTATION

The financial statements have been prepared in accordance with accounting principles and practices generally accepted in the United States of America ("GAAP"). The consolidated statements of operations for the three and nine months ended September 30, 2010 and 2011, the consolidated statement of changes in partners' capital (deficit) for the nine months ended September 30, 2011, the statement of cash flows for the nine months ended September 30, 2010 and 2011, and the consolidated balance sheet as of September 30, 2011 are unaudited. In the opinion of management, the unaudited consolidated financial statements have been prepared on the same basis as the audited financial statements and include all adjustments necessary to present fairly the financial position and results of operations for the respective interim periods. All adjustments are of a recurring nature unless otherwise disclosed herein. The 2010 year-end consolidated balance sheet data was derived from audited financial statements but does not include all disclosures required by GAAP. These consolidated financial statements and notes should be read in conjunction with the consolidated financial statements and notes thereto included in the Partnership's annual report on Form 10-K for the year ended December 31, 2010 filed with the Securities and Exchange Commission (the "SEC") on March 16, 2011 (the "2010 Form 10-K"). Interim financial results are not necessarily indicative of the results to be expected for an annual period. The Partnership's significant accounting policies are consistent with those disclosed in Note 3 of the Notes to Consolidated Financial Statements in our 2010 Form 10-K.

3. RECENT EVENTS

On October 25, 2010, the Partnership entered into a Global Transaction Agreement by and among the Partnership, Blueknight Energy Partners, G.P., L.L.C., which is the Partnership's general partner (the "General Partner"), Vitol ("Vitol" refers to Vitol Holding B.V., its affiliates and subsidiaries other than the Partnership's general partner and the Partnership) and Charlesbank ("Charlesbank" refers to Charlesbank Capital Partners, LLC, its affiliates and subsidiaries other than the Partnership's general partner and the Partnership), pursuant to which the Partnership effected a refinancing of its existing debt. The Global Transaction Agreement contemplated three events comprised of Phase I Transactions, a unitholder vote and Phase II Transactions. Phase I transactions were completed concurrently with the execution of the Global Transaction Agreement. For a detailed description of the Global Transaction Agreement, see the Partnership's 2010 Form 10-K.

On May 12, 2011, the Partnership, the General Partner, Vitol and Charlesbank entered into the First Amendment to Global Transaction Agreement (the "Amendment") pursuant to which the Unitholder Vote Transactions and the Phase II Transactions contemplated in the Global Transaction Agreement were modified.

Pursuant to the Global Transaction Agreement, as amended by the Amendment, the General Partner filed a definitive proxy statement with the Securities and Exchange Commission (the "SEC") relating to a special meeting (the "Unitholder Meeting") that occurred on September 14, 2011 during which the Partnership's unitholders considered and voted upon (i) certain amendments to the Partnership's partnership agreement (the "Partnership Agreement Amendment Proposal") as more fully set forth below and (ii) an amendment to the General Partner's Long-Term Incentive Plan to increase the number of common units issuable under such plan by 1,350,000 common units from 1,250,000 common units to 2,600,000 common units (the "LTIP Proposal"). Pursuant to the Partnership Agreement Amendment Proposal, the Partnership's partnership agreement would be amended to:

- reset (1) the minimum quarterly distribution to $0.11 per unit per quarter from $0.3125 per unit per quarter, (2) the first target distribution to $0.1265 per unit per quarter from $0.3594 per unit per quarter, (3) the second target distribution to $0.1375 per unit per quarter from $0.3906 per unit per quarter and (4) the third target distribution to $0.1825 per unit per quarter from $0.4688 per unit per quarter;

- waive the cumulative common unit arrearage;

- remove provisions in the partnership agreement relating to the subordinated units, including concepts such as a subordination period (and any provisions that expressly apply only during the subordination period) and common unit arrearage, in connection with the transfer to the Partnership, and its subsequent cancellation, of all of the Partnership's outstanding subordinated units;

- provide that distributions shall not accrue or be paid to the holders of the Partnership's incentive distribution rights for an eight quarter period beginning with the quarter in which the special meeting occurs;

- provide that during the period beginning on the date of this special meeting and ending on June 30, 2015 (the "Senior Security Restriction Period"), the Partnership will not issue any class or series of partnership securities that, with respect to distributions on such partnership securities or distributions upon liquidation of the Partnership, ranks senior to the common units during the Senior Security Restriction Period, or "Senior Securities", without the consent of the holders of at least a majority of the outstanding common units (excluding the common units held by the General Partner and its affiliates and excluding any Senior Securities that are convertible into common units), subject to certain exceptions; and

- make certain other amendments relating to the conversion of the Partnership's Series A Preferred Units (the "Preferred Units").

On September 14, 2011, the Partnership's unitholders approved the proposals outlined above. As a result, (i) the General Partner adopted the Fourth Amended and Restated Agreement of Limited Partnership of the Partnership (the "Amended and Restated Partnership Agreement") to reflect the approval of the Partnership Agreement Amendment Proposal, (ii) Vitol and Charlesbank transferred all of the Partnership's outstanding subordinated units to the Partnership and the Partnership cancelled such subordinated units and (iii) the Partnership was obligated to undertake an approximately $77 million rights offering.

On October 3, 2011, the Partnership commenced the rights offering. Pursuant to the terms of the rights offering, the Partnership distributed to its common unitholders of record as of the close of business on September 27, 2011, 0.5412 rights for each outstanding common unit, with each whole right entitling the holder to acquire, for a subscription price of $6.50, a newly issued Preferred Unit. The rights offering expired on October 31, 2011.

The results of the rights offering indicate that the rights offering was over-subscribed and, accordingly, on November 9, 2011, the Partnership issued a total of 11,846,990 Preferred Units to unitholders that exercised their rights. The Partnership received net proceeds of approximately $77 million from the rights offering. The net proceeds from the rights offering, after deducting expenses, were used to redeem convertible debentures in the aggregate principal amount of $50 million plus accrued interest thereon that the Partnership issued to Vitol and Charlesbank (the "Convertible Debentures") and to repurchase an aggregate of 3,225,494 Preferred Units from Vitol and Charlesbank. The Partnership expects that Preferred Units subscribed for in the rights offering will be mailed to participants or credited through DTC on or about Wednesday, November 9, 2011. In addition, the Partnership expects that the

Preferred Units will begin trading on the NASDAQ Global Market on or about Thursday, November 10, 2011 under the symbol “BKEPP.”

4. PROPERTY, PLANT AND EQUIPMENT

	Estimated Useful Lives (Years)	December 31, 2010	September 30, 2011
		(dollars in thousands)	
Land	N/A	$ 15,611	$ 16,981
Land improvements	10-20	5,268	5,731
Pipelines and facilities	5-31	149,402	152,927
Storage and terminal facilities	10-35	166,538	170,226
Transportation equipment	3-10	24,177	20,839
Office property and equipment and other	3-31	21,978	23,500
Pipeline linefill and tank bottoms	N/A	7,763	7,493
Construction-in-progress	N/A	3,067	4,633
Property, plant and equipment, gross		393,804	402,330
Assets held for sale, net		—	928
Accumulated depreciation		(119,735)	(131,634)
Property, plant and equipment, net		$ 274,069	$ 271,624

Depreciation expense for the nine months ended September 30, 2010 and 2011 was $16.2 million and $17.0 million, respectively.

5. DEBT

On October 25, 2010, the Partnership entered into a new credit agreement, which includes a $200.0 million term loan facility and a $75.0 million revolving loan facility. Vitol is a lender under the credit agreement and has committed to loan the Partnership $15.0 million pursuant to such agreement. The entire amount of the term loan and approximately $43.9 million of the revolver was drawn on the transaction date in connection with repaying all existing indebtedness under the Partnership's prior credit agreement. The proceeds of loans made under the credit agreement may be used for working capital and other general corporate purposes of the Partnership.

On April 5, 2011, the Partnership entered into a Joinder Agreement whereby the Partnership's revolving credit facility was increased from $75.0 million to $95.0 million. As of November 7, 2011, approximately $22.7 million of revolver borrowings and letters of credit were outstanding under the credit facility, leaving the Partnership with approximately $72.3 million available capacity for additional revolver borrowings and letters of credit under the credit facility.

The credit agreement is guaranteed by all of the Partnership's existing subsidiaries. Obligations under the credit agreement are secured by first priority liens on substantially all of the Partnership's assets and those of the guarantors, including all material pipeline, gathering and processing assets, all material storage tanks and asphalt facilities, all material working capital assets and a pledge of all of the Partnership's equity interests in its subsidiaries.

The credit agreement includes procedures for additional financial institutions to become revolving lenders, or for any existing lender to increase its revolving commitment thereunder, subject to an aggregate maximum of $200.0 million for all revolving loan commitments under the credit agreement.

The credit agreement will mature on October 25, 2014, and all amounts outstanding under the credit agreement will become due and payable on such date. The Partnership may prepay all loans under the credit agreement at any time without premium or penalty (other than customary LIBOR breakage costs), subject to certain notice requirements. The credit agreement requires mandatory prepayments of amounts outstanding thereunder with the net proceeds of certain asset sales, casualty events and debt incurrences, and, in certain circumstances, with a portion of the Partnership's excess cash flow (as defined in the credit agreement). These mandatory prepayments will be applied to the term loan under the credit agreement until it is repaid in full, then applied to reduce commitments under the revolving loan facility.

Through May 15, 2011, borrowings under the credit agreement bore interest, at the Partnership's option, at either (i) the ABR (the highest of the administrative agent's prime rate, the federal funds rate plus 0.5%, or the one-month eurodollar rate (as defined in the credit agreement) plus 1%), plus an applicable margin of 3.25%, or (ii) the eurodollar rate plus an applicable margin of 4.25%. After approximately May 15, 2011, the applicable margin for loans accruing interest based on the ABR ranges from 3.0% to 3.5%, and the applicable margin for loans accruing interest based on the eurodollar rate ranges from 4.0% to 4.5%, in each case depending on the Partnership's consolidated total leverage ratio (as defined in the credit agreement). The Partnership pays a per annum fee on all letters of credit issued under the credit agreement, which fee equals the applicable margin for loans accruing interest based on the eurodollar rate, and the Partnership pays a commitment fee of 0.50% per annum on the unused availability under the credit agreement. The credit agreement does not have a floor for the ABR or the eurodollar rate. In connection with entering into the credit agreement, the Partnership paid certain upfront fees to the lenders thereunder, and the Partnership paid certain arrangement and other fees to the arranger and administrative agent of the credit agreement. Vitol received its pro rata portion of such fees as a lender under the credit agreement.

The credit agreement includes financial covenants that will be tested on a quarterly basis, based on the rolling four-quarter period that ends on the last day of each fiscal quarter (except for the consolidated interest coverage ratio, which builds to a four-quarter test).

The maximum permitted consolidated total leverage ratio is as follows:

- 4.75 to 1.00 for the fiscal quarters ending September 30, 2011 and December 31, 2011; and
- 4.50 to 1.00 for the fiscal quarter ending March 31, 2012 and each fiscal quarter thereafter.

The minimum permitted consolidated interest coverage ratio (as defined in the credit agreement) is 3.00 to 1.00 for the fiscal quarter ending September 30, 2011 and each fiscal quarter thereafter.

In addition, the credit agreement contains various covenants that, among other restrictions, limit the Partnership's ability to:

- create, incur or assume liens;
- engage in mergers or acquisitions;
- repurchase the Partnership's equity, make distributions to unitholders and make certain other restricted payments;
- make investments;
- modify the terms of the Convertible Debentures (as defined below) and certain other indebtedness, or prepay certain indebtedness;
- engage in transactions with affiliates;
- enter into certain burdensome contracts;
- change the nature of the Partnership's business;
- enter into operating leases; and
- make certain amendments to the Partnership's partnership agreement.

At September 30, 2011, the Partnership's leverage ratio was 3.76 and the interest coverage ratio was 5.01. The Partnership was in compliance with all covenants of its credit agreement as of September 30, 2011.

The credit agreement permits the Partnership to make quarterly distributions of available cash (as defined in the Partnership's partnership agreement) to unitholders so long as: (i) no default or event of default exists under the credit agreement, (ii) the Partnership has, on a pro forma basis after giving effect to such distribution, at least $10.0 million of availability under the revolving loan facility, and (iii) the Partnership's consolidated total leverage ratio, on a pro forma basis, would not be greater than (x) 4.5 to 1.0 for any fiscal quarter on or prior to the fiscal quarter ending June 30, 2011, (y) 4.25 to 1.0 for the fiscal quarters ending September 30, 2011 and December 31, 2011, or (z) 4.00 to 1.0 for any fiscal quarter ending on or after March 31, 2012. The Partnership is currently allowed to make distributions to its unitholders in accordance with these covenants; however, the Partnership will only make distributions to the extent it has sufficient cash from operations after establishment of cash reserves as determined by the General Partner in accordance with the Partnership’s cash distribution policy, including the establishment of any reserves for the proper conduct of the Partnership’s business. See Note 6 for additional information regarding distributions.

Each of the following is an event of default under the credit agreement:

- failure to meet the quarterly financial covenants;
- failure to observe any other agreement, obligation or covenant in the credit agreement or any related loan document, subject to cure periods for certain failures;
- the Partnership's, or any of its subsidiaries', default under other indebtedness that exceeds a threshold amount;
- judgments against the Partnership or any of its subsidiaries, in excess of a threshold amount;
- certain ERISA events involving the Partnership or any of its subsidiaries, in excess of a threshold amount;
- bankruptcy or other insolvency events involving the Partnership or any of its subsidiaries; and
- a change in control (as defined in the credit agreement).

If an event of default relating to bankruptcy or other insolvency events occurs, all indebtedness under the credit agreement will immediately become due and payable. If any other event of default exists under the credit agreement, the lenders may accelerate the maturity of the obligations outstanding under the credit agreement and exercise other rights and remedies. In addition, if any event of default exists under the credit agreement, the lenders may commence foreclosure or other actions against the collateral.

If any default occurs under the credit agreement, or if the Partnership is unable to make any of the representations and warranties in the credit agreement, the Partnership will be unable to borrow funds or have letters of credit issued under the credit agreement.

It will constitute a change of control under the credit agreement if either Vitol or Charlesbank ceases to own, directly or indirectly, exactly 50% of the membership interests of the General Partner or if the General Partner ceases to be controlled by both Vitol and Charlesbank.

Interest expense related to debt issuance cost amortization for the three and nine month periods ended September 30, 2010 was $1.3 million and $3.6 million, respectively, and for the three and nine month periods ended September 30, 2011 was $0.5 million and $1.5 million, respectively. The Partnership capitalized debt issuance costs of $1.1 million during the nine month period ended September 30, 2010, and $0.3 million during the nine months ended September 30, 2011, respectively.

During the three months ended September 30, 2011, the weighted average interest rate under the credit agreement incurred by the Partnership was 4.6% and the total weighted average interest rate, including interest associated with the Convertible Debentures and related debt discount and the Vitol Throughput Capacity Agreement was 12.4% resulting in interest expense of approximately $9.1 million.

In October of 2010 the Partnership issued the Convertible Debentures in a private placement in the aggregate principal amount of $50.0 million. If not previously redeemed, the Convertible Debentures, including all outstanding principal and unpaid interest, will convert to Preferred Units on December 31, 2011. The Partnership redeemed teh Convertible Debentures on November 9, 2011. This conversion feature was considered an embedded derivative, which the Partnership was required to separately value. The Partnership had previously bifurcated this embedded derivative and estimated the fair value each reporting period. In connection with the establishment of the conversion price for the Preferred Units following the special meeting of the Partnership's unitholders in September 2011, the number of Preferred Units issuable upon conversion of the Convertible Debentures would have been an amount equal to (i) the sum of the outstanding principal and any accrued and unpaid interest being converted, divided by (ii) 6.50. The establishment of the conversion rate resulted in the embedded derivative meeting the scope exception in ASC 815-15 –

Embedded Derivatives, and, therefore, the Partnership has reclassified the embedded derivative as partners' capital as of September 30, 2011. The discount created by allocating a portion of the issuance proceeds to the embedded derivative continues to be amortized to interest expense over the term of the Convertible Debentures using the effective interest method.

The Partnership estimated the fair value of the embedded derivative liability to be $27.6 million at December 31, 2010. At September 14, 2011 the fair value of this derivative liability was estimated to be $7.3 million, and subsequently, as noted above, the embedded derivative was reclassified as partners' capital as of September 30, 2011.

Changes to the fair value of the embedded derivative are reflected on the Partnership's consolidated statements of operations as "Change in fair value of embedded derivative within convertible debt." The value of the embedded derivative is contingent on changes in the expected fair value of the Partnership's preferred units. The Partnership recorded other income of $15.4 million and $20.2 million due to the change in the fair value of this embedded derivative in the three and nine months ended September 30, 2011, respectively.

In addition, the recording of the embedded derivative liability related to the Convertible Debentures resulted in the Partnership recording a $20.9 million debt discount on Convertible Debentures. The debt discount is amortized to interest expense through the mandatory conversion date of December 31, 2011 using the effective interest method. The Partnership recognized non-cash interest expense of $4.5 million and $13.2 million in the three and nine months ended September 30, 2011, respectively, due to the amortization of the debt discount.

6. DISTRIBUTIONS

The Partnership has not made a cash distribution to its common unitholders since May 15, 2008 due, in part, to the events of default that existed under its former credit agreement, restrictions under such credit agreement, and the uncertainty of its future cash flows relating to SemCorp's bankruptcy filings ("SemCorp" refers to SemGroup Corporation and its predecessors including SemGroup, L.P., subsidiaries and affiliates other than the Partnership and the General Partner during periods in which the Partnership and the General Partner were affiliated with SemGroup, L.P.). As a result of the approval of the Partnership Agreement Amendment Proposal on September 14, 2011, all cumulative common unit arrearages were eliminated. The Partnership's common unitholders will be required to pay taxes on their share of the Partnership's taxable income even though they did not receive a cash distribution for the quarters ended June 30, 2008 through September 30, 2011. The Partnership is currently allowed to make distributions to its unitholders in accordance with its debt covenants; however, the Partnership will only make distributions to the extent it has sufficient cash from operations after establishment of cash reserves as determined by the General Partner in accordance with the Partnership's cash distribution policy, including the establishment of any reserves for the proper conduct of the Partnership's business. Based on current estimates, management anticipates that it will recommend to the board of directors of the General Partner (the "Board") that the Partnership resume paying distributions on the Partnership's common units beginning with the fourth quarter of 2011 (which distribution would be paid in the first quarter of 2012), however, there can be no assurance that such distribution will be paid.

On October 24, 2011, the Board approved a distribution of $0.14 per Preferred Unit, or a total distribution of $3.0 million. The Partnership paid this distribution on the preferred units on November 7, 2011 to Preferred Unitholders of record as of October 30, 2011.

7. NET INCOME PER COMMON AND SUBORDINATED UNIT

For purposes of calculating earnings per unit, the excess of distributions over earnings or excess of earnings over distributions for each period are allocated to the entities' general partner based on the general partner's ownership interest at the time. The following sets forth the computation of basic and diluted net loss per common and subordinated unit (in thousands, except per unit data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2011	2010	2011
Net income (loss)	$ (2,848)	$ 28,605	$ (10,600)	$ 25,893
Less: Beneficial conversion feature attributable to preferred units	—	11,141	—	33,061
Less: Preferred interest in net income	—	2,975	—	11,124

Less: General partner interest in net income (loss)		(57)		643			(209)		754	
Net income (loss) available to common and subordinated unitholders	$	(2,791)	$	13,846		$	(10,391)	$	(19,046)	
Basic and diluted weighted average number of units:										
Common units		21,728		21,890			21,728		21,890	
Subordinated units		12,571		10,248			12,571		11,788	
Restricted and phantom units		13		456			13		380	
Basic and diluted net income (loss) per common unit	$	(0.08)	$	0.38		$	(0.30)	$	(0.56)	
Basic and diluted net income (loss) per subordinated unit	$	(0.08)	$	0.42	(1)	$	(0.30)	$	(0.52)	(1)

(1) On September 14, 2011, Vitol and Charlesbank transferred all of the Partnership's outstanding subordinated units to the Partnership and the Partnership cancelled such subordinated units. Net income (loss) per subordinated unit represents income (loss) through the September 14, 2011 cancellation of the subordinated units.

8. RELATED PARTY TRANSACTIONS

The Partnership provides crude oil gathering, transportation, terminalling and storage services to Vitol. For the three and nine months ended September 30, 2010, the Partnership recognized revenues of $6.9 million and $15.6 million, respectively, for services provided to Vitol. For the three and nine months ended September 30, 2011, the Partnership recognized revenues of $11.4 million and $31.4 million, respectively, for services provided to Vitol. As of September 30, 2011, the Partnership had receivables from Vitol of $2.8 million.

Vitol Storage Agreements

In connection with the Partnership's acquisition of certain of its crude oil storage assets from SemCorp in May 2008, the Partnership was assigned from SemCorp a storage agreement with Vitol under which the Partnership provides crude oil storage services to Vitol (the "2008 Vitol Storage Agreement"). The initial term of the 2008 Vitol Storage Agreement was from June 1, 2008 through June 30, 2010. This agreement was amended in 2010 to extend the term of the agreement until June 1, 2011 and again in 2011 to extend the term of the agreement to June 1, 2012. Because Vitol was a third party (and not a related or affiliated party) at the time of entering into the 2008 Vitol Storage Agreement, such agreement was not approved by the Board or the Board's conflicts committee in accordance with the Partnership's procedures for approval of related party transactions. Vitol became a related party when it acquired the Partnership's General Partner in November 2009. Since the amendments occurred subsequent to the Vitol Change of Control, they were reviewed and approved by the Board's conflicts committee in accordance with the Partnership's procedures for approval of related party transactions and the provisions of the partnership agreement. The Partnership earned revenues of approximately $3.2 million and $3.3 million from Vitol with respect to services provided pursuant to the 2008 Vitol Storage Agreement for the three month periods ended September 30, 2010 and 2011, respectively. The Partnership earned revenues of approximately $9.2 million and $9.9 million from Vitol with respect to services provided pursuant to the 2008 Vitol Storage Agreement for the nine month periods ended September 30, 2010 and 2011, respectively. The Partnership believes that the rates it charges Vitol under the 2008 Vitol Storage Agreement are fair and reasonable to the Partnership and its unitholders and are comparable with the rates the Partnership charges third parties.

In March of 2010, the Partnership entered into a second crude oil storage services agreement with Vitol under which the Partnership began providing additional crude oil storage services to Vitol effective May 1, 2010 (the "2010 Vitol Storage Agreement"). The initial term of the 2010 Vitol Storage Agreement is five years commencing on May 1, 2010, subject to automatic renewal periods for successive one year periods until terminated by either party with ninety days prior notice. The 2010 Vitol Storage Agreement was reviewed and approved by the Board's conflicts committee in accordance with the Partnership's procedures for approval of related party transactions and the provisions of the partnership agreement. The Partnership generated revenues under this agreement of approximately $3.0 million and $3.1 million during the three month periods ended September 30, 2010 and 2011, respectively. The Partnership generated revenues under this agreement of approximately $5.0 million and $9.2 million during the nine month periods ended September 30, 2010 and 2011, respectively. The Partnership believes that the rates it charges Vitol under the 2010 Vitol Storage Agreement are fair and reasonable to the Partnership and its unitholders and are comparable with the rates the Partnership charges third parties.

Vitol Master Lease Agreement

In July of 2010, the Partnership and Vitol entered into a Master Agreement (the "Master Agreement") relating to the lease of certain vehicles by the Partnership from Vitol. Pursuant to the Master Agreement, the Partnership may lease certain vehicles, including light duty trucks, tractors, tank trailers and bobtail tank trucks, from Vitol for periods ranging from 36 months to 84 months depending on the type of vehicle. The Partnership will have the opportunity to purchase each vehicle at the end of the lease at the estimated residual value of such vehicle. Leases under the Master

Agreement are accounted for as operating leases. During the three and nine months ended September 30, 2011, the Partnership recorded expenses under this agreement of approximately $0.1 million and $0.4 million, respectively. The Master Agreement was approved by the Board's conflicts committee in accordance with the Partnership's procedures for approval of related party transactions and the provisions of its partnership agreement. In September of 2011, the Partnership entered into a new master lease agreement with an unrelated third party and terminated the Master Agreement with Vitol.

Vitol Throughput Capacity Agreement

In August of 2010, the Partnership and Vitol entered into a Throughput Capacity Agreement (the "ENPS Throughput Agreement"). Pursuant to the ENPS Throughput Agreement, Vitol purchased 100% of the throughput capacity on the Partnership's Eagle North Pipeline System ("ENPS"). The Partnership put ENPS in service in December of 2010. In September 2010, Vitol paid the Partnership a prepaid fee equal to \$5.5 million and Vitol will pay additional usage fees for every barrel delivered by or on behalf of Vitol on ENPS. This \$5.5 million fee received from Vitol is accounted for as a long-term payable to a related party and is reflected as such on the Partnership's consolidated balance sheet as of September 30, 2011. In addition, if the payments made by Vitol in any contract year under the ENPS Throughput Agreement are in the aggregate less than \$2.4 million, then Vitol will pay the Partnership a deficiency payment equal to \$2.4 million minus the aggregate amount of all payments made by Vitol during such contract year. The ENPS Throughput Agreement has a term that extends for four years after ENPS is completed and may be extended by mutual agreement of the parties for additional one-year terms. If the capacity on ENPS is unavailable for use by Vitol for more than 60 days, whether consecutive or nonconsecutive, during the term of the ENPS Throughput Agreement, then Vitol shall have the right to terminate the ENPS Throughput Agreement within six months after such lack of capacity. The Partnership has previously contracted to provide throughput services on ENPS to a third party and Vitol's rights to the capacity of ENPS are subordinate to the rights of such third party. In addition, for so long as a default by Vitol relating to payments under the ENPS Throughput Agreement has not occurred and is continuing, the Partnership will remit to Vitol any and all tariffs and deficiency payments received by the Partnership or its affiliates from such third party pursuant to its agreement with the Partnership. The ENPS Throughput Agreement was approved by the Board's conflicts committee in accordance with the Partnership's procedures for approval of related party transactions and the provisions of its partnership agreement.

During the three and nine months ended September 30, 2010, the Partnership incurred interest expense under this agreement of approximately \$0.1 million. During the three and nine months ended September 30, 2011, the Partnership incurred interest expense under this agreement of approximately \$0.2 million and \$0.6 million, respectively. The agreement has an effective annual interest rate of 14.1% and matures on December 31, 2014.

Vitol's Commitment under the Partnership's Credit Agreement

Vitol is a lender under the Partnership's current credit agreement and has committed to loan the Partnership \$15.0 million pursuant to such agreement. During the three and nine months ended September 30, 2011, Vitol received its pro rata portion of the interest payments in connection with being a lender under the credit agreement and received approximately \$0.2 million and \$0.5 million, respectively, in connection therewith.

9. LONG-TERM INCENTIVE PLAN

In July of 2007, the General Partner adopted the Blueknight Energy Partners G.P., L.L.C. Long-Term Incentive Plan (the "Plan"). The compensation committee of the Board administers the Plan. The Plan authorizes the grant of an aggregate of 1.25 million common units deliverable upon vesting. On September 14, 2011, the Partnership's unitholders approved an amendment to the Plan to increase the number of common units issuable under such plan by 1,350,000 common units from 1,250,000 common units to 2,600,000 common units. Although other types of awards are contemplated under the Plan, currently outstanding awards include "phantom" units, which convey the right to receive common units upon vesting, and "restricted" units, which are grants of common units restricted until the time of vesting. The phantom unit awards also include distribution equivalent rights ("DERs").

Subject to applicable earning criteria, a DER entitles the grantee to a cash payment equal to the cash distribution paid on an outstanding common unit prior to the vesting date of the underlying award. Recipients of restricted units are entitled to receive cash distributions paid on common units during the vesting period which distributions are reflected initially as a reduction of partners' capital. Distributions paid on units which ultimately do not vest are reclassified as compensation expense. Awards granted to date are equity awards and, accordingly, the fair value of the awards as of the grant date is expensed over the vesting period.

In March 2011, grants for 299,900 phantom common units were made, all of which vest on January 1, 2014. These grants are equity awards under ASC 718 – Stock Compensation, and, accordingly, the fair value of the awards as of the grant date is expensed over the vesting period. The weighted average grant date fair-value of the awards is $8.25 per unit, which is the closing market price on the March 10, 2011 grant date of the awards. The value of these award grants was approximately $2.5 million on their grant date, and the unrecognized estimated compensation cost at September 30, 2011 was $1.6 million, which will be recognized over the remaining vesting period. As of September 30, 2011, the Partnership expects approximately 75% of these awards will vest. The Partnership's equity-based incentive compensation expense for the three and nine months ended September 30, 2011 was $0.2 million and $0.4 million, respectively.

Activity pertaining to phantom common units and restricted common unit awards granted under the Plan is as follows:

	Number of Shares	Weighted Average Grant Date Fair Value
Nonvested at December 31, 2010	7,500	$ 7.30
Granted	299,900	8.25
Vested	—	—
Forfeited	(1,000)	8.25
Nonvested at September 30, 2011	306,400	$ 8.23

10. EMPLOYEE BENEFIT PLAN

Under the Partnership’s 401(k) Plan, which was formed in 2009, employees who meet specified service requirements may contribute a percentage of their total compensation, up to a specified maximum, to the plan. The Partnership may match each employee’s contribution, up to a specified maximum, in full or on a partial basis. The Partnership recognized expense of $0.2 million and $0.4 million, respectively, for the three months ended September 30, 2010 and 2011, respectively, for discretionary contributions under the plan. The Partnership recognized expense of $0.8 million and $0.9 million, respectively, for the nine months ended September 30, 2010 and 2011, respectively, for discretionary contributions under the plan.

11. FAIR VALUE MEASUREMENTS

The Partnership utilizes a three-tier framework for assets and liabilities required to be measured at fair value. In addition, the Partnership uses valuation techniques, such as the market approach (comparable market prices), the income approach (present value of future income or cash flow), and the cost approach (cost to replace the service capacity of an asset or replacement cost) to value these assets and liabilities as appropriate. The Partnership uses an exit price when determining the fair value. The exit price represents amounts that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants.

The Partnership utilizes a three-tier fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The following is a brief description of those three levels:

Level 1 Observable inputs such as quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 Inputs other than quoted prices that are observable for these assets or liabilities, either directly or indirectly. These include quoted prices for similar assets or liabilities in active markets and quoted prices for identical or similar assets or liabilities in markets that are not active.

Level 3 Unobservable inputs in which there is little market data, which requires the reporting entity to develop its own assumptions

This hierarchy requires the use of observable market data, when available, and to minimize the use of unobservable inputs when determining fair value.

The Partnership's recurring financial assets and liabilities subject to fair value measurements and the necessary disclosures are as follows (in thousands):

Fair Value Measurements as of December 31, 2010

Description	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Liabilities:				
Fair value of derivative embedded within the Convertible Debentures	$ 27,550	$ —	$ —	$ 27,550
Fair value of rights offering liability	$ 10,441	$ —	$ —	$ 10,441
Total	$ 37,991	$ —	$ —	$ 37,991

Description	Total	Fair Value Measurements as of September 30, 2011 Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Liabilities:				
Fair value of rights offering liability	$ 8,603	$ —	$ —	$ 8,603
Total	$ 8,603	$ —	$ —	$ 8,603

The fair value of the embedded derivative within the Convertible Debentures was derived using a valuation model and has been classified as Level 3. The valuation model used is a discounted cash flow model (income approach) that assumes future distribution payments by the Partnership and utilizes interest rates and credit spreads for subordinated debt to preferred stock to determine the fair value of the derivative embedded within the Convertible Debentures. The change in fair value of the derivative liability for the three and nine months ended September 30, 2011 of $15.4 million and $20.2 million, respectively, is included in other (income) expense in the Partnership's consolidated statements of operations. In connection with the establishment of the conversion price for the Preferred Units following the special meeting of the Partnership's unitholders in September 2011, the number of Preferred Units issuable upon conversion of the Convertible Debentures will be an amount equal to (i) the sum of the outstanding principal and any accrued and unpaid interest being converted, divided by (ii) 6.50. The establishment of the conversion rate resulted in the embedded derivative meeting the scope exception in ASC 815-15 – Embedded Derivatives, and, therefore, the Partnership has reclassified the embedded derivative as partners' capital as of September 30, 2011.

The fair value of the rights offering liability related to certain rights that have been offered to common unitholders under the approved Global Transaction Agreement was derived using a valuation model and has been classified as Level 3. The valuation model used is a probability-weighted model (income approach) and assumes the number of rights that are exercised as well as the expected fair value of the Preferred Units at the time such rights are exercised. The change in fair value of the rights offering liability for the three and nine months ended September 30, 2011 of $8.2 million and $1.8 million, respectively, is included in other (income) expense in the Partnership's consolidated statements of operations.

The following table sets forth a reconciliation of changes in the fair value of the Partnership's financial liabilities classified as Level 3 in the fair value hierarchy (in thousands):

	Measurements Using Significant Unobservable Inputs (Level 3) For the Three Months Ended September 30, 2011	For the Nine Months Ended September 30, 2011
Beginning Balance	$ 39,511	$ 37,991
Total gains or losses (realized/unrealized)		
Included in earnings	(23,582)	(22,062)
Included in other comprehensive income	—	—
Purchases, issuances, and settlements(1)	(7,326)	(7,326)
Transfers in and/or out of Level 3	—	—
Balance at September 30, 2011	$ 8,603	$ 8,603
	$ (8,224)	$ (1,838)

The amount of total income for the period included in earnings attributable to the change in unrealized gains for liabilities still held at the reporting date	

(1) As noted above, the Partnership reclassified the embedded derivative within Convertible Debentures to partners' capital as of September 30, 2011.

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12. OPERATING SEGMENTS

The Partnership's operations consist of four operating segments: (i) crude oil terminalling and storage services, (ii) crude oil pipeline services, (iii) crude oil trucking and producer field services, and (iv) asphalt services. During the fourth quarter of 2010, the Partnership changed the structure of its internal organization in a manner that caused the composition of its reportable segments to change. Previously, the crude oil pipeline services segment and the crude oil trucking and producer field services segment were presented on a combined basis. The change in the Partnership's internal organization was prompted by the December 2010 acquisition of a producer field services business and the December 2010 placement of the ENPS into service. All periods prior to this change in the Partnership's internal organization have been restated to reflect the Partnership's current operating segments.

CRUDE OIL TERMINALLING AND STORAGE SERVICES —The Partnership provides crude oil terminalling and storage services at its terminalling and storage facilities located in Oklahoma and Texas.

CRUDE OIL PIPELINE SERVICES —The Partnership owns and operates three pipeline systems, the Mid-Continent system, the Longview system and ENPS, that gather crude oil purchased by its customers and transports it to refiners, to common carrier pipelines for ultimate delivery to refiners or to terminalling and storage facilities owned by the Partnership and others. The Partnership refers to its pipeline system located in Oklahoma and the Texas Panhandle as the Mid-Continent system. It refers to its second pipeline system, which is located in Texas, as the Longview system. In December 2010, the Partnership placed into service a third pipeline system, ENPS, originating in Cushing, Oklahoma and terminating in Ardmore, Oklahoma.

CRUDE OIL TRUCKING AND PRODUCER FIELD SERVICES — The Partnership uses its owned and leased tanker trucks to gather crude oil for its customers at remote wellhead locations generally not covered by pipeline and gathering systems and to transport the crude oil to aggregation points and storage facilities located along pipeline gathering and transportation systems. Crude oil producer field services consist of a number of producer field services, ranging from gathering condensates from natural gas companies to hauling produced water to disposal wells.

ASPHALT SERVICES —The Partnership provides asphalt product and residual fuel terminalling, storage and blending services at its terminalling and storage facilities located in twenty-two states.

The Partnership's management evaluates performance based upon segment operating margin, which includes revenues from related parties and external customers and operating expenses excluding depreciation and amortization. The non-GAAP measure of operating margin (in the aggregate and by segment) is presented in the following table. The Partnership computes the components of operating margin by using amounts that are determined in accordance with GAAP. A reconciliation of operating margin to income (loss) before income taxes, which is its nearest comparable GAAP financial measure, is included in the following table. The Partnership believes that investors benefit from having access to the same financial measures being utilized by management. Operating margin is an important measure of the economic performance of the Partnership's core operations. This measure forms the basis of the Partnership's internal financial reporting and is used by its management in deciding how to allocate capital resources between segments. Income (loss) before income taxes, alternatively, includes expense items, such as depreciation and amortization, general and administrative expenses and interest expense, which management does not consider when evaluating the core profitability of the Partnership's operations.

The following table reflects certain financial data for each segment for the periods indicated (in thousands):

	Crude Oil Terminalling and Storage Services	Crude Oil Pipeline Services	Crude Oil Trucking and Producer Field Services	Asphalt Services	Total	
Three Months Ended September 30, 2010						
Service revenue						
Third party revenue	$ 3,274	$ 2,702	$ 10,331	$ 14,806	$ 31,113	
Related party revenue	6,393	394	156	—	6,943	
Total revenue for reportable segments	9,667	3,096	10,487	14,806	38,056	
Operating expenses (excluding depreciation and amortization)	1,155	2,450	9,657	4,864	18,126	
Operating margin (excluding depreciation and amortization)	8,512	646	830	9,942	19,930	(1)
Total assets (end of period)	77,359	71,455	18,223	128,919	295,956	
Three Months Ended September 30, 2011						
Service revenue						
Third party revenue	$ 2,941	$ 4,408	$ 10,170	$ 17,605	$ 35,124	
Related party revenue	6,683	1,220	3,484	—	11,387	
Total revenue for reportable segments	9,624	5,628	13,654	17,605	46,511	
Operating expenses (excluding depreciation and amortization)	1,143	2,977	12,126	5,720	21,966	
Operating margin (excluding depreciation and amortization)	8,481	2,651	1,528	11,885	24,545	(1)
Total assets (end of period)	75,304	102,730	16,071	126,670	320,775	
Nine months Ended September 30, 2010						
Service revenue						
Third party revenue	$ 14,777	$ 8,609	$ 31,297	$ 43,212	$ 97,895	
Related party revenue	14,759	650	228	—	15,637	
Total revenue for reportable segments	29,536	9,259	31,525	43,212	113,532	
Operating expenses (excluding depreciation and amortization)	2,888	7,772	30,318	16,236	57,214	
Operating margin (excluding depreciation and amortization)	26,648	1,487	1,207	26,976	56,318	(1)
Total assets (end of period)	77,359	71,455	18,223	128,919	295,956	
Nine months Ended September 30, 2011						
Service revenue						
Third party revenue	$ 8,316	$ 13,301	$ 32,634	$ 45,497	$ 99,748	
Related party revenue	20,748	3,401	7,228	—	31,377	
Total revenue for reportable segments	29,064	16,702	39,862	45,497	131,125	
	3,261	11,768	36,635	16,996	68,660	

Operating expenses (excluding depreciation and amortization)						
Operating margin (excluding depreciation and amortization)	25,803	4,934	3,227	28,501	62,465	(1)
Total assets (end of period)	75,304	102,730	16,071	126,670	320,775	

(1) The following table reconciles segment operating margin (excluding depreciation and amortization) to income (loss) before income taxes (in thousands):

	Three Months Ended September 30,		Nine months Ended September 30,	
	2010	2011	2010	2011
Operating margin (excluding depreciation and amortization)	$ 19,930	$ 24,545	$ 56,318	$ 62,465
Depreciation and amortization	5,315	5,651	16,228	17,066
General and administrative expenses	3,883	4,679	11,037	14,065
Interest expense	13,530	9,120	39,502	27,284
Change in fair value of embedded derivative within convertible debt	—	(15,358)	—	(20,224)
Change in fair value of contingent dividends	—	(8,224)	—	(1,838)
Income (loss) before income taxes	$ (2,798)	$ 28,677	$ (10,449)	$ 26,112

13. COMMITMENTS AND CONTINGENCIES

The Partnership is subject to various legal actions and claims, including a securities class action and other lawsuits, an SEC investigation and a Grand Jury investigation due to events related to SemCorp's bankruptcy filings.

On May 3, 2011, the Partnership entered into a Stipulation of Settlement (the "Stipulation") to settle the consolidated securities class action litigation, In Re: SemGroup Energy Partners, L.P. Securities Litigation, Case No. 08-MD-1989-GKF-FHM (the "Class Action Litigation"), pending in the U.S. District Court for the Northern District of Oklahoma. As set forth more fully in the Stipulation, when given final approval by the court, among other things, the shareholder class will receive a total payment of approximately $28.0 million from the defendants. On June 9, 2011, the Court entered an order preliminarily approving, subject to further consideration at a settlement hearing, the proposed settlement pursuant to the Stipulation involving, among other things, a dismissal of the Class Action Litigation with prejudice. The Court held a hearing on October 5, 2011 and granted final approval of the proposed settlement and issued a final judgment (the "Judgment") in accordance with the Stipulation. The Judgment became final on November 7, 2011.

In the fourth quarter of 2010, the Partnership recorded a contingent loss of $20.2 million related to its portion of the settlement and a related insurance recovery receivable of $13.0 million. This contingent loss and insurance recovery receivable are reflected on the Partnership's balance sheet as of September 30, 2011. The net loss of $7.2 million attributable to this action was recognized in the fourth quarter of 2010. In June of 2011, the Partnership paid $0.5 million towards the settlement in escrow. This $0.5 million is reflected as a current asset on the Partnership's balance sheet as of September 30, 2011 and will be applied to the accrued settlement liability in October of 2011 as a result of the final approval of the proposed settlement. Pursuant to the Stipulation and the Judgment, on October 12, 2011, the Partnership issued and transferred 767,414 common units with a value equal to approximately $5.2 million to lead plaintiff's counsel in the Class Action Litigation. The transfer of the 767,414 common units is the final payment to the class by the Partnership required by the Stipulation and the Judgment. Furthermore, in October of 2011, the Partnership recognized the $13.0 million of insurance proceeds associated with the previously recorded insurance recovery receivable when the settlement was funded by the insurers. No parties admit any wrongdoing as part of the settlement.

On July 21, 2008, the Partnership received a letter from the staff of the Securities and Exchange Commission (the "SEC") giving notice that the SEC is conducting an inquiry relating to the Partnership and requesting, among other things, that the Partnership voluntarily preserve, retain and produce to the SEC certain documents and information relating primarily to the Partnership's disclosures respecting SemCorp's liquidity issues, which were the subject of the Partnership's July 17, 2008 press release. On October 21, 2008, the Partnership received a subpoena from the SEC pursuant to a formal order of investigation requesting certain documents relating to, among other things, SemCorp's liquidity issues. The Partnership received a subpoena from the SEC in connection with the investigation requesting that the Partnership produce additional documents by November 20, 2010 and additional documents were produced in January 2011. The Partnership has been cooperating, and intends to continue cooperating, with the SEC in its investigation. On October 18, 2011, the SEC announced that it had reached a settlement with Thomas L. Kivisto, a former member of the Board, with respect to certain asserted claims against Mr. Kivisto.

On October 27, 2008, Keystone Gas Company ("Keystone") filed suit against the Partnership in Oklahoma State District Court in Creek County alleging that it is the rightful owner of certain segments of the Partnership's pipelines and related rights of way, located in Payne and Creek Counties, that the Partnership acquired from SemCorp in connection with the Partnership's initial public offering in 2007. Keystone seeks to quiet title to the specified rights of way and pipelines and seeks damages up to the net profits derived from the disputed pipelines. There has been no determination of the extent of potential damages for the Partnership's use of such pipelines. The Partnership has filed a counterclaim against Keystone alleging that it is wrongfully using a segment of a pipeline that is owned by the

Partnership in Payne and Creek Counties. The parties are engaged in discovery. The Partnership intends to vigorously defend these claims. No trial date has been set by the court.

In March and April 2009, nine current or former executives of SemCorp and certain of its affiliates filed wage claims with the Oklahoma Department of Labor against the Partnership's general partner. Their claims arise from the Partnership's general partner's Long-Term Incentive Plan, Employee Phantom Unit Agreement ("Phantom Unit Agreement"). Most claimants alleged that phantom units previously awarded to them vested upon the Change of Control that occurred in July 2008. One claimant alleged that his phantom units vested upon his termination. The claimants contended the Partnership's general partner's failure to deliver certificates for the phantom units within 60 days after vesting caused them to be damaged, and they sought recovery of approximately $2.0 million in damages and penalties. On April 30, 2009, all of the wage claims were dismissed on jurisdictional grounds by the Department of Labor.

On July 8, 2009, the nine executives filed suit against the Partnership's general partner in Tulsa County district court claiming they are entitled to recover the value of phantom units purportedly due them under the Phantom Unit Agreement. The claimants assert claims against the Partnership's general partner for alleged failure to pay wages and breach of contract and seek to recover the alleged value of units in the total amount of approximately $1.3 million, plus additional damages and attorneys' fees. The Partnership has distributed phantom units to certain of the claimants. On April 14, 2010, a Tulsa County district court judge ruled in favor of seven of the claimants, and awarded them approximately $1.0 million in damages. The Partnership has appealed this ruling. On October 22, 2010, the Partnership's general partner was ordered to pay $0.2 million in attorneys' fees. The Partnership has also appealed this order.

The Official Committee of Unsecured Creditors of SemCrude, L.P. ("Unsecured Creditors Committee") filed an adversary proceeding in connection with SemCorp's bankruptcy cases against Thomas L. Kivisto, Gregory C. Wallace, and Westback Purchasing Company, L.L.C. In that proceeding, filed February 18, 2009, the Unsecured Creditors Committee asserted various claims against the defendants on behalf of SemCorp's bankruptcy estate, including claims based upon theories of fraudulent transfer, breach of fiduciary duties, waste, breach of contract, and unjust enrichment. On June 8, 2009, the Unsecured Creditors Committee filed a Second Amended Complaint asserting additional claims against Kevin L. Foxx and Alex G. Stallings, among others, based upon certain findings and recommendations in the examiner's report. On October 6, 2009, a Third Amended Complaint was filed, and in December 2009, the Litigation Trust was substituted as the Plaintiff in the action. The claims in the Third Amended Complaint against Mr. Foxx and Mr. Stallings are based upon theories of fraudulent transfer, unjust enrichment, waste, breach of fiduciary duty, and breach of contract. Messrs. Foxx and Stallings moved to dismiss the claims against them.

On July 14, 2010, the Litigation Trust filed another adversary proceeding against Mr. Foxx, seeking to avoid certain transfers from SemCorp to Mr. Foxx and to bar Mr. Foxx from asserting claims in SemCorp's bankruptcy.

Messrs. Kivisto, Wallace, Cooper, Foxx and Stallings have reached an agreement with the Litigation Trust to settle the claims against them in the adversary proceedings described above. The agreement calls for the payment of $30 million to the Trust out of the proceeds of certain SemCorp insurance policies. In exchange, the Trust will provide a release of claims against Messrs. Kivisto, Wallace, Cooper, Foxx and Stallings. The court approved the settlement over an objection, which was subsequently appealed. The objector, the Trust, and Messrs. Kivisto, Wallace, Cooper, Foxx and Stallings reached an agreement to resolve that appeal on October 11, 2011. Pursuant to that agreement, the court dismissed the appeal, and the settlement became final, on October 26, 2011.

On July 24, 2009, the Partnership filed suit against Navigators Insurance Company ("Navigators") and Darwin National Assurance Company ("Darwin") in Tulsa County district court. In that suit, the Partnership is seeking a declaratory judgment that Darwin and Navigators did not have the right to rescind binders issued to the Partnership for three excess insurance policies in its Directors and Officers insurance program for the period from July 18, 2008 to July 18, 2009. The face amount of two of the policies was $10,000,000, and the face amount of the third policy was $5,000,000. The suit seeks a declaratory judgment that the binders were enforceable insurance contracts of Navigators and Darwin that have not been rescinded or cancelled. The suit also alleges that the attempted rescissions were in breach of contract and violated the duty of good faith and fair dealing, for which the Partnership is seeking the recovery of damages and attorneys' fees. This case has been temporarily stayed pursuant to the terms of a Settlement Agreement and Release (the "Settlement Agreement") between the Partnership, Navigators, and Darwin.
The Settlement Agreement was entered into as part of the settlement of the Class Action Litigation. The Court held a hearing on October 5, 2011 and granted final approval of the proposed Class Action Litigation settlement and issued the final Judgment in accordance with the Stipulation signed in the Class Action Litigation. Pursuant to the Stipulation, the Judgment became final on November 7, 2011. Pursuant to the Settlement Agreement, the Partnership will dismiss with prejudice the suit against Navigators and Darwin on or before November 17, 2011.

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Koch Industries, Inc. (together with its subsidiaries, “Koch”), a previous owner of the Partnership’s asphalt facility located in Northumberland, Pennsylvania, has alleged that the Partnership has responsibility to assess the polychlorinated biphenyl (“PCB”) contamination at such facility although the contamination occurred prior to the Partnership becoming the owner of such facility. Koch claims that it was absolved of its responsibility to assess and clean up the site during SemCorp’s bankruptcy proceedings. The Partnership contends that Koch retained responsibility for such environmental issues and that SemCorp’s bankruptcy proceedings did not absolve Koch of these liabilities. On July 6, 2011, the Partnership filed an adversary complaint in connection with SemCorp’s bankruptcy cases against Koch seeking a declaration that SemCorp’s bankruptcy proceedings did not impact Koch’s responsibility to assess and clean the Northumberland site. A responsive pleading has been filed by Koch. The Partnership intends to vigorously defend against Koch’s allegation that the Partnership should be required to assess or clean up the PCB contamination.

On July 11, 2011, ExxonMobil filed suit against the Partnership in Harris County District Court, State of Texas, requesting damages in excess of $35,000 from the Partnership and other, third party service providers in connection with the relocation of existing pipelines of ExxonMobil and the Partnership. The Partnership has filed its answer to the claims and asserted cross-claims against third party service providers including the subcontractors of ExxonMobil. ExxonMobil had previously sent a settlement demand seeking approximately $1.9 million in damages. The Partnership intends to vigorously defend these claims.

The Partnership may become the subject of additional private or government actions regarding these matters in the future. Litigation may be time-consuming, expensive and disruptive to normal business operations, and the outcome of litigation is difficult to predict. The defense of these lawsuits may result in the incurrence of significant legal expense, both directly and as the result of the Partnership’s indemnification obligations. The litigation may also divert management’s attention from the Partnership’s operations which may cause its business to suffer. An unfavorable outcome in any of these matters may have a material adverse effect on the Partnership’s business, financial condition, results of operations, cash flows, ability to make distributions to its unitholders, the trading price of the Partnership’s common units and its ability to conduct its business. All or a portion of the defense costs and any amount the Partnership may be required to pay to satisfy a judgment or settlement of these claims may not be covered by insurance.

The Partnership is from time to time subject to various legal actions and claims incidental to its business, including those arising out of environmental-related matters. Management believes that these legal proceedings will not have a material adverse effect on the financial position, results of operations or cash flows of the Partnership. Once management determines that information pertaining to a legal proceeding indicates that it is probable that a liability has been incurred and the amount of such liability can be reasonably estimated, an accrual is established equal to its estimate of the likely exposure.

The Partnership has contractual obligations to perform dismantlement and removal activities in the event that some of its asphalt product and residual fuel oil terminalling and storage assets are abandoned. These obligations include varying levels of activity including completely removing the assets and returning the land to its original state. The Partnership has determined that the settlement dates related to the retirement obligations are indeterminate. The assets with indeterminate settlement dates have been in existence for many years and with regular maintenance will continue to be in service for many years to come. Also, it is not possible to predict when demands for the Partnership’s terminalling and storage services will cease, and the Partnership does not believe that such demand will cease for the foreseeable future. Accordingly, the Partnership believes the date when these assets will be abandoned is indeterminate. With no reasonably determinable abandonment date, the Partnership cannot reasonably estimate the fair value of the associated asset retirement obligations. Management believes that if the Partnership’s asset retirement obligations were settled in the foreseeable future the potential cash flows that would be required to settle the obligations based on current costs are not material. The Partnership will record asset retirement obligations for these assets in the period in which sufficient information becomes available for it to reasonably determine the settlement dates.

14. INCOME TAXES

The Partnership has entered into storage contracts and leases with third party customers with respect to substantially all of its asphalt facilities. At the time of entering into such agreements, it was unclear under current tax law as to whether the rental income from the leases, and the fees attributable to certain of the processing services the Partnership provides under certain of the storage contracts, constitute “qualifying income.” In the second quarter of 2009, the Partnership submitted a request for a ruling from the IRS that rental income from the leases constitutes “qualifying income.” In October 2009, the Partnership received a favorable ruling from the IRS. As part of this ruling, however, the Partnership agreed to transfer, and has transferred, certain of its asphalt processing assets and related fee income to a subsidiary taxed as a corporation. This transfer occurred in the first quarter of 2010. Such subsidiary is required to pay federal income tax on its income at the corporate tax rate, which is currently a maximum of 35%, and will likely pay state (and possibly local) income tax at varying rates. Distributions from this subsidiary will generally be taxed again to unitholders as corporate distributions and none of the income, gains, losses, deductions or credits of this subsidiary will flow through to the Partnership’s unitholders.

In relation to the Partnership’s taxable subsidiary, the tax effects of temporary differences between the tax basis of assets and liabilities and their financial reporting amounts and the tax credits and other items that give rise to significant portions of the deferred tax assets at September 30, 2011 are presented below (dollars in thousands):

Deferred tax assets	
Difference in bases of property, plant and equipment	$ 1,231,008
Net operating loss carryforwards	51,158
Deferred tax asset	1,282,166
Less: valuation allowance	(1,282,166)
Net deferred tax asset	$ —

Given the Partnership’s subsidiary taxed as a corporation has no earnings history to determine the likelihood of realizing the benefits of the deferred tax assets and