

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 20-F

(Mark One)

**REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) or (g)
OF THE SECURITIES EXCHANGE ACT OF 1934**

OR

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

For the fiscal year ended December 31, 2008

OR

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

OR

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

Date of event requiring this shell company report.....

For the transition period from _____ to _____

Commission file number 1-33198

TEEKAY OFFSHORE PARTNERS L.P.

(Exact name of Registrant as specified in its charter)

Not Applicable

(Translation of Registrant's Name into English)

Republic of The Marshall Islands

(Jurisdiction of incorporation or organization)

4th floor, Belvedere Building, 69 Pitts Bay Road, Hamilton, HM 08, Bermuda
(Address of principal executive offices)

Roy Spires
4th floor, Belvedere Building, 69 Pitts Bay Road, Hamilton, HM 08, Bermuda
Telephone: (441) 298-2530
Fax: (441) 292-3931
(Contact Information for Company Contact Person)

Securities registered or to be registered pursuant to Section 12(b) of the Act.

Title of each class
Common Units

Name of each exchange on which registered
New York Stock Exchange

Securities registered or to be registered pursuant to Section 12(g) of the Act.

None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act.

None

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report.

20,425,000 Common Units
9,800,000 Subordinated Units

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes No

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, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP International Financial Reporting Standards as issued by the International Accounting Standards Board Other

If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow:

Item 17 Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

**TEEKAY OFFSHORE PARTNERS L.P.
INDEX TO REPORT ON FORM 20-F**

		<u>Page</u>
PART I.		
Item 1.	Identity of Directors, Senior Management and Advisors	Not applicable
Item 2.	Offer Statistics and Expected Timetable	Not applicable
Item 3.	Key Information	8
Item 4.	Information on the Partnership	24
Item 4A.	Unresolved Staff Comments	Not applicable
Item 5.	Operating and Financial Review and Prospects	40
Item 6.	Directors, Senior Management and Employees.....	57
Item 7.	Major Unitholders and Related Party Transactions.....	61
Item 8.	Financial Information	64
Item 9.	The Offer and Listing	65
Item 10.	Additional Information.....	66
Item 11.	Quantitative and Qualitative Disclosures About Market Risk.....	68
Item 12.	Description of Securities Other than Equity Securities	Not applicable
PART II.		
Item 13.	Defaults, Dividend Arrearages and Delinquencies.....	69
Item 14.	Material Modifications to the Rights of Unitholders and Use of Proceeds	69
Item 15.	Controls and Procedures.....	70
Item 16A.	Audit Committee Financial Expert	71
Item 16B.	Code of Ethics	71
Item 16C.	Principal Accountant Fees and Services.....	71
Item 16D.	Exemptions from the Listing Standards for Audit Committees.....	Not applicable
Item 16E.	Purchases of Units by the Issuer and Affiliated Purchasers	Not applicable
PART III.		
Item 17.	Financial Statements	Not applicable
Item 18.	Financial Statements	72
Item 19.	Exhibits	73
Signatures	74

PART I

This Annual Report should be read in conjunction with the consolidated financial statements and accompanying notes included in this report.

Unless otherwise indicated, references in this Annual Report to "Teekay Offshore," "we," "us" and "our" and similar terms refer to Teekay Offshore Partners L.P. and/or one or more of its subsidiaries, including Teekay Offshore Operating L.P. (or OPCO), except that those terms, when used in this Annual Report in connection with the common units described herein, shall mean specifically Teekay Offshore Partners L.P. References in this Annual Report to "Teekay Corporation" refer to Teekay Corporation and/or any one or more of its subsidiaries.

In addition to historical information, this Annual Report contains forward-looking statements that involve risks and uncertainties. Such forward-looking statements relate to future events and our operations, objectives, expectations, performance, financial condition and intentions. When used in this Annual Report, the words "expect," "intend," "plan," "believe," "anticipate," "estimate" and variations of such words and similar expressions are intended to identify forward-looking statements. Forward-looking statements in this Annual Report include, in particular, statements regarding:

- our ability to make cash distributions on our units or any increases in quarterly distributions;
- our future financial condition or results of operations and future revenues and expenses;
- growth prospects of the offshore and tanker markets;
- offshore and tanker market fundamentals, including the balance of supply and demand in the offshore and tanker markets;
- the expected lifespan of a new shuttle tanker, floating storage and off-take (or FSO) unit and conventional tanker;
- estimated capital expenditures and the availability of capital resources to fund capital expenditures;
- our ability to maintain long-term relationships with major crude oil companies;
- the recent economic downturn and crisis in the global financial markets, including disruptions in the global credit and stock markets and potential negative effects on our customers' ability to charter our vessels and pay for our services;
- our ability to leverage to our advantage Teekay Corporation's relationships and reputation in the shipping industry;
- our continued ability to enter into fixed-rate time charters with customers;
- obtaining offshore projects that we or Teekay Corporation bid on or that Teekay Corporation is awarded;
- our ability to maximize the use of our vessels, including the re-deployment or disposition of vessels no longer under long-term time charter;
- the ability of the counterparties to our derivative contracts to fulfill their contractual obligations;
- our pursuit of strategic opportunities, including the acquisition of vessels and expansion into new markets vessels;
- our expected financial flexibility to pursue acquisitions and other expansion opportunities;
- anticipated funds for liquidity needs and the sufficiency of cash flows;
- the expected cost of, and our ability to comply with, governmental regulations and maritime self regulatory organization standards applicable to our business;
- the expected impact of heightened environmental and quality concerns of insurance underwriters, regulators and charterers;
- anticipated taxation of our partnership and its subsidiaries;
- Teekay Corporation offering to us additional interest in Teekay Offshore Operating L.P.;
- our general and administrative expenses as a public company and expenses under service agreements with other affiliates of Teekay Corporation and for reimbursements of fees and costs of our general partner; and
- our business strategy and other plans and objectives for future operations.

Forward-looking statements are necessarily estimates reflecting the judgment of senior management, involve known and unknown risks and are based upon a number of assumptions and estimates that are inherently subject to significant uncertainties and contingencies, many of which are beyond our control. Actual results may differ materially from those expressed or implied by such forward-looking statements. Important factors that could cause actual results to differ materially include, but are not limited to, those factors discussed below in Item 3: Key Information—Risk Factors and other factors detailed from time to time in other reports we file with the U.S. Securities and Exchange Commission (or the SEC).

We do not intend to revise any forward-looking statements in order to reflect any change in our expectations or events or circumstances that may subsequently arise. You should carefully review and consider the various disclosures included in this Annual Report and in our other filings made with the SEC that attempt to advise interested parties of the risks and factors that may affect our business, prospects and results of operations.

Item 1. Identity of Directors, Senior Management and Advisors

Not applicable.

Item 2. Offer Statistics and Expected Timetable

Not applicable.

Item 3. Key Information

Selected Financial Data

The following tables present, in each case for the periods and as of the dates indicated, summary:

- historical financial and operating data of Teekay Offshore Partners Predecessor (as defined below); and
- financial and operating data of Teekay Offshore Partners L.P. and its subsidiaries since its initial public offering on December 19, 2006.

Prior to the closing of our initial public offering of common units on December 19, 2006, Teekay Corporation transferred eight Aframax conventional crude oil tankers to a subsidiary of Norsk Teekay Holdings Ltd. (or *Norsk Teekay*) and one FSO unit to Teekay Offshore Australia Trust. Teekay Corporation then transferred to Teekay Offshore Operating L.P. (or *OPCO*) all of the outstanding interests of four wholly-owned subsidiaries — Norsk Teekay, Teekay Nordic Holdings Inc., Teekay Offshore Australia Trust and Pattani Spirit L.L.C. These four wholly-owned subsidiaries, which include the eight Aframax conventional crude oil tankers and the FSO unit, are collectively referred to as *Teekay Offshore Partners Predecessor* or the *Predecessor*.

The summary historical financial and operating data has been prepared on the following basis:

- the historical financial and operating data of Teekay Offshore Partners Predecessor as at and for the years ended December 31, 2004 and 2005 is derived from the audited combined consolidated financial statements of Teekay Offshore Partners Predecessor;
- the historical financial and operating data of Teekay Offshore Partners Predecessor for the period from January 1, 2006 to December 18, 2006 is derived from the audited combined consolidated financial statements of Teekay Offshore Partners Predecessor; and
- the historical financial and operating data of Teekay Offshore Partners L.P. as at December 31, 2006, 2007 and 2008, for the period from December 19, 2006 to December 31, 2006, and for the years ended December 31, 2007 and 2008, reflect our initial public offering and are derived from our audited consolidated financial statements.

In July 2007, we acquired from Teekay Corporation ownership of its 100% interest in the 2000-built shuttle tanker *Navion Bergen* and its 50% interest in the 2006-built shuttle tanker *Navion Gothenburg*. The acquisitions included the assumption of debt, related interest rate swap agreements and Teekay Corporation's rights and obligations under 13-year, fixed-rate bareboat charters. In October 2007, we acquired from Teekay Corporation its interest in the FSO unit *Dampier Spirit*, along with its 7-year fixed-rate time-charter. In June 2008, we acquired from Teekay Corporation its interests in two 2008-built Aframax-class lightering tankers, the *SPT Explorer* and the *SPT Navigator*. This acquisition included the assumption of debt and Teekay Corporation's rights and obligations under the 10-year, fixed-rate bareboat charters (with options exercisable by the charterer to extend up to an additional five years). These transactions were deemed to be business acquisitions between entities under common control. Accordingly, we have accounted for these transactions in a manner similar to the pooling of interest method. Under this method of accounting, our financial statements prior to the date the interests in these vessels were actually acquired by us are retroactively adjusted to include the results of these acquired vessels. The periods retroactively adjusted include all periods that we and the acquired vessels were both under common control of Teekay Corporation and had begun operations. As a result, our applicable consolidated financial statements reflect these vessels and the results of operations of the vessels, referred to herein as the *Dropdown Predecessor*, as if we had acquired them when each respective vessel began operations under the ownership of Teekay Corporation. These vessels began operations on April 16, 2007 (*Navion Bergen*), July 24, 2007 (*Navion Gothenburg*), March 15, 1998 (*Dampier Spirit*), January 7, 2008 (*SPT Explorer*) and March 28, 2008 (*SPT Navigator*). Please read Note 1 to our consolidated financial statements included in this Annual Report.

Our initial public offering and certain other transactions that occurred during 2006, 2007 and 2008 have affected our historical performance or will affect our future performance. As a result, the following tables should be read together with, and are qualified in their entirety by reference to, (a) "Item 5. Operating and Financial Review and Prospects," included herein, and (b) the historical consolidated financial statements and the accompanying notes and the Report of Independent Registered Public Accounting Firm therein (which are included herein), with respect to the consolidated financial statements for the years ended December 31, 2008, 2007, and 2006 aggregated as follows:

Year ended December 31, 2008

- January 1 to December 31, 2008

Year ended December 31, 2007

- January 1 to December 31, 2007

Year ended December 31, 2006

- January 1 to December 18, 2006
- December 19 to December 31, 2006

Our consolidated financial statements are prepared in accordance with United States generally accepted accounting principles (or *GAAP*).

	Year Ended December 31,		Year Ended December 31, 2006		Year Ended December 31,	
	2004	2005	January 1 to December 18, 2006	December 19 to December 31, 2006	2007	2008
Income Statement Data:						
Voyage revenues	\$ 723,217	\$ 613,246	\$ 617,514	\$ 24,397	\$ 785,203	\$ 872,492
Operating expenses:						
Voyage expenses ⁽¹⁾	90,414	74,543	91,321	3,102	151,637	225,029
Vessel operating expenses ^{(2) (14)}	109,278	109,480	107,991	4,297	149,660	184,416
Time-charter hire expense	177,050	169,687	159,973	5,641	150,463	132,234
Depreciation and amortization	120,197	109,824	100,823	3,726	124,370	38,437
General and administrative ⁽¹⁴⁾	45,941	56,726	63,014	2,177	62,404	64,230
(Gain) loss on sale of vessels and equipment - net of writedowns	(3,725)	2,820	(4,778)	-	-	-
Restructuring charge	-	955	832	-	-	-
Total operating expenses	539,155	524,035	519,176	18,943	638,534	744,346
Income from vessel operations	184,062	89,211	98,338	5,454	146,669	128,146
Interest expense ⁽¹⁴⁾	(44,268)	(39,983)	(64,462)	(1,617)	(126,304)	(215,727)
Interest income	2,459	4,612	5,167	191	5,871	4,086
Equity income from joint ventures	5,514	5,955	6,321	-	-	-
Gain on sales of marketable securities	94,222	-	-	-	-	-
Foreign currency exchange (loss) gain ⁽³⁾	(37,840)	34,228	(66,214)	(118)	(11,678)	4,343
Other - net	14,064	9,091	8,367	309	10,403	11,936
Income tax (expense) recovery	(29,465)	12,375	(3,260)	(121)	10,516	56,704
Income (loss) from continuing operations before non-controlling interest	188,748	115,489	(15,743)	4,098	35,477	(10,512)
Non-controlling interest	(2,167)	(229)	(3,893)	(2,636)	(31,519)	(7,122)
Income (loss) from continuing operations	186,581	115,260	(19,636)	1,462	3,958	(17,634)
Net income (loss) from discontinued operations ⁽⁴⁾	30,619	(19,347)	(10,656)	-	-	-
Net income (loss)	\$ 217,200	\$ 95,913	\$ (30,292)	\$ 1,462	\$ 3,958	\$ (17,634)
Dropdown Predecessor's interest in net income	4,076	\$ 2,910	\$ 3,097	\$ 114	\$ 1,300	\$ 1,333
General partner's interest in net income	-	-	-	64	733	8,918
Limited partners' interest:						
Net income (loss) from continuing operations	182,505	112,350	(22,733)	1,284	1,925	(27,885)
Net Income (loss) from continuing operations per:						
Common unit (basic and diluted) ⁽⁵⁾	14.48	8.92	(1.80)	0.07	0.12	(0.90)
Subordinated unit (basic and diluted) ⁽⁵⁾	14.48	8.92	(1.80)	0.06	0.07	(0.90)
Total unit (basic and diluted) ⁽⁵⁾	14.48	8.92	(1.80)	0.07	0.10	(0.90)
Limited partners' interest:						
Net income (loss)	213,124	93,003	(33,389)	1,284	1,925	(27,885)
Net income (loss) per:						
Common unit (basic and diluted) ⁽⁵⁾	16.91	7.38	(2.65)	0.07	0.12	(0.90)
Subordinated unit (basic and diluted) ⁽⁵⁾	16.91	7.38	(2.65)	0.06	0.07	(0.90)
Total unit (basic and diluted) ⁽⁵⁾	16.91	7.38	(2.65)	0.07	0.10	(0.90)
Cash distributions declared per unit	-	-	-	-	1.14	1.65
Balance Sheet Data (at end of year):						
Cash and marketable securities ^{(4) (6)}	\$ 143,729	\$ 128,986	\$ -	\$ 113,986	\$ 121,224	\$ 131,488
Vessels and equipment ^{(7) (8)}	1,440,167	1,310,135	-	1,532,743	1,662,865	1,708,006
Total assets	2,054,760	1,895,601	-	2,081,224	2,166,351	2,180,092
Total debt	1,178,132	943,319	-	1,303,352	1,517,467	1,566,436
Non-controlling interest	14,276	11,859	-	427,977	392,613	201,383
Dropdown Predecessor's equity	44,016	47,784	-	51,792	-	-
Total partners'/owner's equity	659,212	747,879	-	138,942	77,401	100,866
Common units outstanding ⁽⁵⁾	2,800,000	2,800,000	2,800,000	9,800,000	9,800,000	15,461,202
Subordinated units outstanding ⁽⁵⁾	9,800,000	9,800,000	9,800,000	9,800,000	9,800,000	9,800,000
Cash Flow Data:						
Net cash provided by (used in):						
Operating activities ⁽⁹⁾	\$ 247,184	\$ 157,881	\$ -	\$ -	\$ 45,847	\$ 122,566
Financing activities ⁽⁹⁾	(74,302)	(206,748)	-	-	(23,905)	38,806
Investing activities ⁽⁹⁾	(190,110)	34,124	-	-	(14,704)	(151,108)
Other Financial Data:						
Net voyage revenues ⁽¹⁰⁾	\$ 632,803	\$ 538,703	\$ 526,193	\$ 21,295	\$ 633,566	\$ 647,463
EBITDA ⁽¹¹⁾	409,638	229,199	133,086	6,735	238,245	275,740
Capital expenditures:						
Expenditures for vessels and equipment ⁽¹²⁾	170,630	24,760	31,079	-	31,228	57,858
Expenditures for drydocking	9,174	8,906	31,255	-	49,053	29,075
Fleet data:						
Average number of shuttle tankers ⁽¹³⁾	37.9	35.8	33.9	36.0	36.9	36.6
Average number of conventional tankers ⁽¹³⁾	40.7	41.2	22.0	10.0	9.3	10.7
Average number of FSO units ⁽¹³⁾	4.0	4.0	4.0	4.0	4.6	5.0

- (1) Voyage expenses are all expenses unique to a particular voyage, including any bunker fuel expenses, port fees, cargo loading and unloading expenses, canal tolls, agency fees and commissions.
- (2) Vessel operating expenses include crewing, repairs and maintenance, insurance, stores, lube oils and communication expenses.
- (3) Substantially all of these foreign currency exchange gains and losses were unrealized and not settled in cash. Under U.S. accounting guidelines, all foreign currency-denominated monetary assets and liabilities, such as cash and cash equivalents, accounts receivable, accounts payable, advances from affiliates and deferred income taxes, are revalued and reported based on the prevailing exchange rate at the end of the period. For the periods prior to our initial public offering, our primary source of foreign currency gains and losses were our Norwegian Kroner-denominated advances from affiliates, which were settled by the Predecessor prior to our initial public offering on December 19, 2006.
- (4) On July 1, 2006, the Predecessor sold Navion Shipping Ltd. to a subsidiary of Teekay Corporation for \$53.7 million. At the time of the sale, all of the Predecessor's chartered-in conventional tankers were chartered-in by Navion Shipping Ltd. and subsequently time chartered to a subsidiary of Teekay Corporation at charter rates that provided a fixed 1.25% profit margin. These chartered-in conventional tankers were operated in the spot market by the subsidiary of Teekay Corporation.
- (5) Net income (loss) per unit is determined by dividing net income (loss), after deducting the amount of net income (loss) attributable to the Dropdown Predecessor and the amount of net income (loss) allocated to our general partner's interest for periods subsequent to our initial public offering on December 19, 2006, by the weighted-average number of units outstanding during the period. For periods prior to December 19, 2006, such units are deemed equal to the common and subordinated units received by Teekay Corporation in exchange for a 26.0% interest in OPCO in connection with our initial public offering.
- (6) Cash and marketable securities include cash from discontinued operations of \$13.4 million and \$2.5 million as at December 31, 2004, and 2005, respectively.
- (7) Vessels and equipment consists of (a) vessels, at cost less accumulated depreciation, (b) vessels under capital leases, at cost less accumulated depreciation, and (c) advances on newbuildings.
- (8) Vessels and equipment includes a vessel held for sale of \$19.6 million as at December 31, 2004.
- (9) For the year ended December 31, 2006, cash flow data provided by (used in) operating activities, financing activities and investing activities was \$162,228, (\$230,238) and \$53,010, respectively.
- (10) Consistent with general practice in the shipping industry, we use net voyage revenues (defined as voyage revenues less voyage expenses) as a measure of equating revenues generated from voyage charters to revenues generated from time charters, which assists us in making operating decisions about the deployment of vessels and their performance. Under time charters and bareboat charters, the charterer typically pays the voyage expenses, which are all expenses unique to a particular voyage, including any bunker fuel expenses, port fees, cargo loading and unloading expenses, canal tolls, agency fees and commissions, whereas under voyage charter contracts and contracts of affreightment the shipowner typically pays the voyage expenses. Some voyage expenses are fixed, and the remainder can be estimated. If we or OPCO, as the shipowner, pay the voyage expenses, we or OPCO typically pass the approximate amount of these expenses on to the customers by charging higher rates under the contract or billing the expenses to them. As a result, although voyage revenues from different types of contracts may vary, the net revenues after subtracting voyage expenses, which we call net voyage revenues, are comparable across the different types of contracts. We principally use net voyage revenues, a non-GAAP financial measure, because it provides more meaningful information to us than voyage revenues, the most directly comparable GAAP financial measure. Net voyage revenues are also widely used by investors and analysts in the shipping industry for comparing financial performance between companies in the shipping industry to industry averages. The following table reconciles net voyage revenues with voyage revenues.

	Year Ended December 31, 2004	Year Ended December 31, 2005	Year Ended December 31, 2006		Year Ended December 31, 2007	Year Ended December 31, 2008
			January 1 to December 18, 2006	December 19 to December 2006		
Voyage revenues	\$723,217	\$613,246	\$617,514	\$24,397	\$785,203	\$872,492
Voyage expenses	90,414	74,543	91,321	3,102	151,637	225,029
Net voyage revenues	\$632,803	\$538,703	\$526,193	\$21,295	\$633,566	\$647,463

- (11) EBITDA. Earnings before interest, taxes, depreciation and amortization is used as a supplemental financial measure by management and by external users of our financial statements, such as investors, as discussed below:
 - *Financial and operating performance.* EBITDA assists our management and investors by increasing the comparability of the fundamental performance of us from period to period and against the fundamental performance of other companies in our industry that provide EBITDA information. This increased comparability is achieved by excluding the potentially disparate effects between periods or companies of interest expense, taxes, depreciation or amortization, which items are affected by various and possibly changing financing methods, capital structure and historical cost basis and which items may significantly affect net income between periods. We believe that including EBITDA as a financial and operating measure benefits investors in (a) selecting between investing in us and other investment alternatives and (b) monitoring our ongoing financial and operational strength and health in assessing whether to continue to hold our common units.
 - *Liquidity.* EBITDA allows us to assess the ability of assets to generate cash sufficient to service debt, make distributions and undertake capital expenditures. By eliminating the cash flow effect resulting from the existing capitalization of us and OPCO and other items such as drydocking expenditures, working capital changes and foreign currency exchange gains and losses (which may vary significantly from period to period), EBITDA provides a consistent measure of our ability to generate cash over the long term. Management uses this

information as a significant factor in determining (a) our and OPCO's proper capitalization (including assessing how much debt to incur and whether changes to the capitalization should be made) and (b) whether to undertake material capital expenditures and how to finance them, all in light of existing cash distribution commitments to unitholders. Use of EBITDA as a liquidity measure also permits investors to assess the fundamental ability of OPCO and us to generate cash sufficient to meet cash needs, including distributions on our common units.

EBITDA should not be considered an alternative to net income, operating income, cash flow from operating activities or any other measure of financial performance or liquidity presented in accordance with GAAP. EBITDA excludes some, but not all, items that affect net income and operating income, and these measures may vary among other companies. Therefore, EBITDA as presented by us may not be comparable to similarly titled measures of other companies.

	Year Ended December 31,		Year Ended December 31, 2006		Year Ended December 31,	
	2004	2005	January 1 to December 18, 2006	December 19 to December 31, 2006	2007	2008
<i>Reconciliation of "EBITDA" to "Net income (loss)":</i>						
Net income (loss)	\$ 217,200	\$ 95,913	\$ (30,292)	\$ 1,462	\$ 3,958	\$ (17,634)
Depreciation and amortization	120,197	109,824	100,823	3,726	124,370	138,437
Interest expense, net	41,809	35,371	59,295	1,426	120,433	211,641
Income taxes expense (recovery)	29,465	(12,375)	3,260	121	(10,516)	(56,704)
Depreciation and amortization and income tax expense related to discontinued operations	967	466	-	-	-	-
EBITDA ⁽¹⁾	\$ 409,638	\$ 229,199	\$ 133,086	\$ 6,735	\$ 238,245	\$ 275,740
<i>Reconciliation of "EBITDA" to "Net operating cash flow":</i>						
Net operating cash flow	\$ 247,184	\$ 157,881	\$ 162,112	\$ 116	\$ 45,847	\$ 122,566
Non-controlling interest	(2,167)	(229)	(3,893)	(2,636)	(31,519)	(7,122)
Expenditures for drydocking	9,174	8,906	31,255	-	49,053	29,075
Interest expense, net	41,809	35,371	59,295	1,426	120,433	211,641
(Loss) gain on sale of vessels	3,725	9,423	6,928	-	-	-
Gain on sale of marketable securities, net of writedowns	94,222	-	-	-	-	-
Loss on writedown of vessels and equipment	-	(12,243)	(2,150)	-	-	-
Write-off of debt issuance costs	-	-	(2,790)	-	-	-
Equity income (net of dividends received)	(1,986)	3,205	319	-	-	-
Change in working capital	36,757	(26,539)	(50,673)	7,134	33,706	(22,943)
Distribution from subsidiaries to non-controlling interest	2,347	9,618	4,224	-	78,107	71,976
Change in fair value of interest rate swaps	-	-	2,647	699	(45,491)	(130,482)
Foreign currency exchange (loss) gain and other, net	(21,427)	43,806	(74,188)	(4)	(11,891)	1,029
EBITDA ⁽¹⁾	\$ 409,638	\$ 229,199	\$ 133,086	\$ 6,735	\$ 238,245	\$ 275,740

(1) EBITDA is net of non-controlling interest expense of \$2.2 million, \$0.2 million, \$3.9 million, \$2.6 million, \$31.5 million and \$7.1 million for the years ended December 31, 2004 and 2005, and for the periods January 1 to December 18, 2006 and December 19 to December 31, 2006, and for the years ended December 31, 2007 and 2008, respectively.

EBITDA also includes the following items:

	Year Ended December 31,		Year Ended December 31, 2006		Year Ended December 31,	
	2004	2005	January 1 to December 18, 2006	December 19 to December 31, 2006	2007	2008
	\$	\$	\$	\$	\$	\$
(Loss) gain on sale of vessels and equipment, net of writedowns	\$ 3,725	\$ (2,820)	\$ 4,778	\$ -	\$ -	\$ -
Gain on sale of marketable securities, net of writedowns	94,222	-	-	-	-	-
Unrealized gains (losses) on foreign currency forward contracts	-	-	-	-	(466)	(4,137)
Foreign currency exchange (loss) gain	(37,840)	34,228	(66,214)	(118)	(11,678)	4,343
	\$ 60,107	\$ 31,408	\$ (61,436)	\$ (118)	\$ (12,144)	\$ 206

- (12) Expenditures for vessels and equipment excludes non-cash investing activities. Please read Item 18 – Financial Statements: Note 14 - Supplemental Cash Flow Information.
- (13) Average number of ships consists of the average number of owned and chartered-in vessels (including those in discontinued operations) that were in our possession during the period (excluding five vessels owned by OPCO's 50% joint ventures for periods prior to December 1, 2006, but including two vessels deemed to be in our possession for accounting purposes as a result of the inclusion of the Dropdown Predecessor prior to our actual acquisition of such vessels). On December 1, 2006, the operating agreements for these five joint ventures were amended, resulting in OPCO controlling these entities and in their being consolidated with OPCO in accordance with GAAP.
- (14) Vessel operating expenses, general and administrative expenses and interest expense includes unrealized gains (losses) on derivative instruments. Please read Item 18 – Financial Statements: Note 11 – Derivative Instruments and Hedging Activities.

RISK FACTORS

Our cash flow depends substantially on the ability of our subsidiaries, primarily OPCO, to make distributions to us.

The source of our cash flow consists nearly exclusively of cash distributions from our subsidiaries, primarily OPCO, which also makes distributions to Teekay Corporation, its other partner. The amount of cash OPCO and other subsidiaries can distribute to us principally depends upon the amount of cash they generate from their operations, which may fluctuate from quarter to quarter based on, among other things:

- the rates they obtain from their charters and contracts of affreightment (whereby OPCO or other subsidiaries carry an agreed quantity of cargo for a customer over a specified trade route within a given period of time);
- the price and level of production of, and demand for, crude oil, particularly the level of production at the offshore oil fields OPCO or other subsidiaries service under contracts of affreightment;
- the level of their operating costs, such as the cost of crews and insurance;
- the number of off-hire days for their vessels and the timing of, and number of days required for, drydocking of vessels;
- the rates, if any, at which OPCO or other subsidiaries may be able to redeploy shuttle tankers in the spot market as conventional oil tankers during any periods of reduced or terminated oil production at fields serviced by contracts of affreightment;
- delays in the delivery of any newbuildings or vessels undergoing conversion and the beginning of payments under charters relating to those vessels;
- prevailing global and regional economic and political conditions;
- currency exchange rate fluctuations; and
- the effect of governmental regulations and maritime self-regulatory organization standards on the conduct of business.

The actual amount of cash OPCO or other subsidiaries have available for distribution also depends on other factors such as:

- the level of their capital expenditures, including for maintaining vessels or converting existing vessels for other uses and complying with regulations;
- their debt service requirements and restrictions on distributions contained in their debt instruments;
- fluctuations in their working capital needs;
- their ability to make working capital borrowings; and
- the amount of any cash reserves, including reserves for future maintenance capital expenditures, working capital and other matters, established by the Board of Directors of our general partner.

OPCO's limited partnership agreement provides that it distributes its available cash (as defined in the partnership agreement) to its partners on a quarterly basis. OPCO's available cash includes cash on hand less any reserves that may be appropriate for operating its business. The amount of OPCO's quarterly distributions, including the amount of cash reserves not distributed, is determined by the Board of Directors of our general partner on our behalf.

The amount of cash OPCO or other subsidiaries generate from operations may differ materially from their profit or loss for the period, which will be affected by non-cash items. As a result of this and the other factors mentioned above, OPCO and other subsidiaries may make cash distributions during periods when they record losses and may not make cash distributions during periods when they record net income.

We may not have sufficient cash from operations to enable us to pay the minimum quarterly distribution on our common units or to maintain or increase distributions.

The source of our earnings and cash flow consists nearly exclusively of cash distributions from our subsidiaries, primarily OPCO. Therefore, the amount of distributions we are able to make to our unitholders will fluctuate based on the level of distributions made to us by our subsidiaries. Neither OPCO nor any other subsidiaries may make quarterly distributions at a level that will permit us to make distributions to our common unitholders at the minimum quarterly distribution level set forth in our partnership agreement or to maintain or increase our quarterly distributions in the future. In addition, while we would expect to increase or decrease distributions to our unitholders if our subsidiaries increase or decrease

distributions to us, the timing and amount of any such increased or decreased distributions will not necessarily be comparable to the timing and amount of the increase or decrease in distributions made by our subsidiaries to us.

Our ability to distribute to our unitholders any cash we may receive from our subsidiaries is or may be limited by a number of factors, including, among others:

- interest expense and principal payments on any indebtedness we incur;
- restrictions on distributions contained in any of our current or future debt agreements;
- fees and expenses of us, our general partner, its affiliates or third parties we are required to reimburse or pay, including expenses we incur as a result of being a public company; and
- reserves our general partner believes are prudent for us to maintain for the proper conduct of our business or to provide for future distributions.

Many of these factors reduce the amount of cash we may otherwise have available for distribution. We may not be able to pay distributions, and any distributions we do make may not be at or above our minimum quarterly distribution. The actual amount of cash that is available for distribution to our unitholders depends on several factors, many of which are beyond the control of us or our general partner.

Our ability to grow may be adversely affected by our cash distribution policy. OPCO's ability to meet its financial needs and grow may be adversely affected by its cash distribution policy.

Our cash distribution policy, which is consistent with our partnership agreement, requires us to distribute all of our available cash (as defined in our partnership agreement) each quarter. Accordingly, our growth may not be as fast as businesses that reinvest their available cash to expand ongoing operations.

OPCO's cash distribution policy requires it to distribute all of its available cash each quarter. In determining the amount of cash available for distribution by OPCO, the Board of Directors of our general partner, in making the determination on our behalf, approves the amount of cash reserves to set aside by OPCO, including reserves for future maintenance capital expenditures, working capital and other matters. OPCO also relies upon external financing sources, including commercial borrowings, to fund its capital expenditures. Accordingly, to the extent OPCO does not have sufficient cash reserves or is unable to obtain financing, its cash distribution policy may significantly impair its ability to meet its financial needs or to grow.

We must make substantial capital expenditures to maintain the operating capacity of our fleet, which reduces cash available for distribution. In addition, each quarter our general partner is required to deduct estimated maintenance capital expenditures from operating surplus, which may result in less cash available to unitholders than if actual maintenance capital expenditures were deducted.

We must make substantial capital expenditures to maintain, over the long term, the operating capacity of our fleet. We intend to continue to expand our fleet, which would increase the level of our maintenance capital expenditures. Maintenance capital expenditures include capital expenditures associated with drydocking a vessel, modifying an existing vessel or acquiring a new vessel to the extent these expenditures are incurred to maintain the operating capacity of our fleet. These expenditures could increase as a result of changes in:

- the cost of labor and materials;
- customer requirements;
- increases in fleet size or the cost of replacement vessels;
- governmental regulations and maritime self-regulatory organization standards relating to safety, security or the environment; and
- competitive standards.

In addition, actual maintenance capital expenditures vary significantly from quarter to quarter based on the number of vessels drydocked during that quarter. Significant maintenance capital expenditures reduce the amount of cash that OPCO has available to distribute to us and that we have available for distribution to our unitholders.

Our partnership agreement requires our general partner to deduct our estimated, rather than actual, maintenance capital expenditures from operating surplus each quarter in an effort to reduce fluctuations in operating surplus (as defined in our partnership agreement). The amount of estimated maintenance capital expenditures deducted from operating surplus is subject to review and change by the conflicts committee of our general partner at least once a year. In years when estimated maintenance capital expenditures are higher than actual maintenance capital expenditures, the amount of cash available for distribution to unitholders is lower than if actual maintenance capital expenditures were deducted from operating surplus. If our general partner underestimates the appropriate level of estimated maintenance capital expenditures, we may have less cash available for distribution in future periods when actual capital expenditures begin to exceed our previous estimates.

We require substantial capital expenditures to expand the size of our fleet. We generally are required to make significant installment payments for acquisitions of newbuilding vessels or for the conversion of existing vessels prior to their delivery and generation of revenue. Depending on whether we finance our expenditures through cash from operations or by issuing debt or equity securities, our ability to make cash distributions may be diminished or our financial leverage may increase or our unitholders may be diluted.

We make substantial capital expenditures to increase the size of our fleet. In 2007, we purchased from Teekay Corporation its interests in two shuttle tankers and one FSO unit. In 2008, we purchased a shuttle tanker from a third party and we purchased from Teekay Corporation two conventional tankers and Teekay Corporation is obligated to offer us its interests in additional vessels. In 2008, we also purchased from Teekay

Corporation an additional 25% limited partner interest in OPCO. Please read Item 4: Information on the Partnership—Overview, History and Development, for information about these recent and potential acquisitions.

Currently, the total delivered cost for a shuttle tanker is approximately \$50 to \$130 million, the cost of converting an existing tanker to an FSO unit is approximately \$20 to \$50 million and a floating, production, storage and off-take (or FPSO) unit is approximately \$100 million to \$1.5 billion, although actual costs vary significantly depending on the market price charged by shipyards, the size and specifications of the vessel, governmental regulations and maritime self-regulatory organization standards.

We and Teekay Corporation regularly evaluate and pursue opportunities to provide marine transportation services for new or expanding offshore projects. Teekay Corporation currently is seeking to provide transportation services for several offshore projects. Under an omnibus agreement that we have entered into in connection with our initial public offering, Teekay Corporation is required to offer to us, within 365 days of their deliveries, certain shuttle tankers, FSO units and FPSO units Teekay Corporation may acquire or has acquired, including certain vessels of Teekay Corporation's subsidiary Teekay Petrojarl ASA. Neither we nor Teekay Corporation may be awarded charters or contracts of affreightment relating to any of the projects we pursue or it pursues, and we may choose not to purchase the vessels Teekay Corporation is required to offer to us under the omnibus agreement. If we obtain from Teekay Corporation any offshore project, we will incur significant capital expenditures to build the offshore vessels needed to fulfill the project requirements.

We generally are required to make installment payments on newbuildings prior to their delivery. We typically must pay between 10% to 20% of the purchase price of a shuttle tanker upon signing the purchase contract, even though delivery of the completed vessel will not occur until much later (approximately three to four years from the time the order is placed). If we finance these acquisition costs by issuing debt or equity securities, we will increase the aggregate amount of interest or minimum quarterly distributions we must make prior to generating cash from the operation of the newbuilding.

To fund the remaining portion of existing or future capital expenditures, we will be required to use cash from operations or incur borrowings or raise capital through the sale of debt or additional equity securities. Use of cash from operations will reduce cash available for distribution to unitholders. Our ability to obtain bank financing or to access the capital markets for future offerings may be limited by our financial condition at the time of any such financing or offering as well as by adverse market conditions resulting from, among other things, general economic conditions and contingencies and uncertainties that are beyond our control. Our failure to obtain the funds for future capital expenditures could have a material adverse effect on our business, results of operations and financial condition and on our ability to make cash distributions. Even if we are successful in obtaining necessary funds, the terms of such financings could limit our ability to pay cash distributions to unitholders. In addition, incurring additional debt may significantly increase our interest expense and financial leverage, and issuing additional equity securities may result in significant unitholder dilution and would increase the aggregate amount of cash required to meet our minimum quarterly distribution to unitholders, which could have a material adverse effect on our ability to make cash distributions.

Our substantial debt levels may limit our flexibility in obtaining additional financing, pursuing other business opportunities and paying distributions to you.

If we are awarded contracts for additional offshore projects or otherwise acquire additional vessel or businesses, our consolidated debt may significantly increase. As at December 31, 2008, our total debt was \$1,566.4 million and we had the ability to borrow an additional \$142.7 million under our revolving credit facilities, subject to limitations in the credit facilities. We may incur additional debt under these or future credit facilities. Our level of debt could have important consequences to us, including:

- our ability to obtain additional financing, if necessary, for working capital, capital expenditures, acquisitions or other purposes may be impaired or such financing may not be available on favorable terms;
- we will need a substantial portion of our cash flow to make principal and interest payments on our debt, reducing the funds that would otherwise be available for operations, future business opportunities and distributions to unitholders;
- our debt level may make us more vulnerable than our competitors with less debt to competitive pressures or a downturn in our industry or the economy generally; and
- our debt level may limit our flexibility in responding to changing business and economic conditions.

Our ability to service our debt depends upon, among other things, our future financial and operating performance, which will be affected by prevailing economic conditions and financial, business, regulatory and other factors, some of which are beyond our control. If our operating results are not sufficient to service our current or future indebtedness, we will be forced to take actions such as reducing distributions, reducing or delaying our business activities, acquisitions, investments or capital expenditures, selling assets, restructuring or refinancing our debt, or seeking additional equity capital or bankruptcy protection. We may not be able to effect any of these remedies on satisfactory terms, or at all.

Financing agreements containing operating and financial restrictions may restrict our business and financing activities.

The operating and financial restrictions and covenants in our financing arrangements and any future financing agreements for us could adversely affect our ability to finance future operations or capital needs or to engage, expand or pursue our business activities. For example, the arrangements may restrict the ability of us, OPCO or other subsidiaries to:

- incur or guarantee indebtedness;
- change ownership or structure, including mergers, consolidations, liquidations and dissolutions;
- make dividends or distributions;
- make certain negative pledges and grant certain liens;
- sell, transfer, assign or convey assets;

- make certain investments; and
- enter into a new line of business.

In addition, five revolving credit facilities require OPCO to maintain a minimum liquidity (cash, cash equivalents and undrawn committed revolving credit lines with at least six months of maturity) of \$75.0 million, with aggregate liquidity of not less than 5.0% of the total consolidated debt of OPCO and its subsidiaries. Two other revolving credit facilities are guaranteed by Teekay Corporation and require Teekay Corporation to maintain the greater of a minimum liquidity of at least \$50.0 million and 5.0% of its total consolidated debt. The ability of Teekay Corporation, us or OPCO to comply with covenants and restrictions contained in debt instruments may be affected by events beyond their, its or our control, including prevailing economic, financial and industry conditions. If market or other economic conditions deteriorate, compliance with these covenants may be impaired. If restrictions, covenants, ratios or tests in the financing agreements are breached, a significant portion of the obligations may become immediately due and payable, and the lenders' commitment to make further loans may terminate. Neither Teekay Corporation, we or OPCO might have, or be able to obtain, sufficient funds to make these accelerated payments. In addition, obligations under our credit facilities are secured by certain vessels, and if we are unable to repay debt under the credit facilities, the lenders could seek to foreclose on those assets.

Restrictions in our debt agreements may prevent us, OPCO or other subsidiaries from paying distributions.

The payment of principal and interest on our debt reduces cash available for distribution to us and on our units. In addition, our, OPCO's and other subsidiaries' financing agreements prohibit the payment of distributions upon the occurrence of the following events, among others:

- failure to pay any principal, interest, fees, expenses or other amounts when due;
- failure to notify the lenders of any material oil spill or discharge of hazardous material, or of any action or claim related thereto;
- breach or lapse of any insurance with respect to vessels securing the facilities;
- breach of certain financial covenants;
- failure to observe any other agreement, security instrument, obligation or covenant beyond specified cure periods in certain cases;
- default under other indebtedness;
- bankruptcy or insolvency events;
- failure of any representation or warranty to be materially correct;
- a change of control, as defined in the applicable agreement; and
- a material adverse effect, as defined in the applicable agreement.

We derive a substantial majority of our revenues from a limited number of customers, and the loss of any such customers could result in a significant loss of revenues and cash flow.

We have derived, and we believe we will continue to derive, a substantial majority of revenues and cash flow from a limited number of customers. StatoilHydro ASA, Teekay Corporation and Petrobras Transporte S.A. accounted for approximately 37%, 21% and 13%, respectively, of consolidated voyage revenues from continuing operations during 2008. StatoilHydro ASA, Teekay Corporation and Petrobras Transporte S.A. accounted for approximately 39%, 20% and 13%, respectively, of consolidated voyage revenues from continuing operations during 2007. Teekay Corporation and StatoilHydro ASA accounted for approximately 12% and 30%, respectively, of consolidated voyage revenues from continuing operations during 2006. No other customer accounted for 10% or more of revenues from continuing operations during any of these periods.

If we lose a key customer, we may be unable to obtain replacement long-term charters or contracts of affreightment and may become subject, with respect to any shuttle tankers redeployed on conventional oil tanker trades, to the volatile spot market, which is highly competitive and subject to significant price fluctuations. If a customer exercises its right under some charters to purchase the vessel, we may be unable to acquire an adequate replacement vessel. Any replacement newbuilding would not generate revenues during its construction and we may be unable to charter any replacement vessel on terms as favorable to us as those of the terminated charter.

The loss of any of our significant customers could have a material adverse effect on our business, results of operations and financial condition and our ability to make cash distributions.

We depend on Teekay Corporation to assist us in operating our businesses and competing in our markets.

We, OPCO and operating subsidiaries of us and OPCO have entered into various services agreements with certain subsidiaries of Teekay Corporation pursuant to which those subsidiaries will provide to us and OPCO all of our and OPCO's administrative services and to the operating subsidiaries substantially all of their managerial, operational and administrative services (including vessel maintenance, crewing, purchasing, shipyard supervision, insurance and financial services) and other technical and advisory services. Our operational success and ability to execute our growth strategy depends significantly upon the satisfactory performance of these services by the Teekay Corporation subsidiaries. Our business will be harmed if such subsidiaries fail to perform these services satisfactorily or if they stop providing these services to us, OPCO or the operating subsidiaries.

Our ability to compete for offshore oil marine transportation, processing and storage projects and to enter into new charters or contracts of affreightment and expand our customer relationships depends largely on our ability to leverage our relationship with Teekay Corporation and its reputation and relationships in the shipping industry. If Teekay Corporation suffers material damage to its reputation or relationships, it may harm the ability of us, OPCO or other subsidiaries to:

- renew existing charters and contracts of affreightment upon their expiration;
- obtain new charters and contracts of affreightment;
- successfully interact with shipyards during periods of shipyard construction constraints;
- obtain financing on commercially acceptable terms; or
- maintain satisfactory relationships with suppliers and other third parties.

If our ability to do any of the things described above is impaired, it could have a material adverse effect on our business, results of operations and financial condition and our ability to make cash distributions.

Our operating subsidiaries may also contract with certain subsidiaries of Teekay Corporation for the Teekay Corporation subsidiaries to have newbuildings constructed or existing vessels converted on behalf of the operating subsidiaries and to incur the construction-related financing. The operating subsidiaries would purchase the vessels on or after delivery based on an agreed-upon price. None of our operating subsidiaries currently has this type of arrangement with Teekay Corporation or any of its affiliates.

Our growth depends on continued growth in demand for offshore oil transportation, processing and storage services.

Our growth strategy focuses on expansion in the shuttle tanker, FSO and FPSO sectors. Accordingly, our growth depends on continued growth in world and regional demand for these offshore services, which could be negatively affected by a number of factors, such as:

- decreases in the actual or projected price of oil, which could lead to a reduction in or termination of production of oil at certain fields we service or a reduction in exploration for or development of new offshore oil fields;
- increases in the production of oil in areas linked by pipelines to consuming areas, the extension of existing, or the development of new, pipeline systems in markets we may serve, or the conversion of existing non-oil pipelines to oil pipelines in those markets;
- decreases in the consumption of oil due to increases in its price relative to other energy sources, other factors making consumption of oil less attractive or energy conservation measures;
- availability of new, alternative energy sources; and
- negative global or regional economic or political conditions, particularly in oil consuming regions, which could reduce energy consumption or its growth.

Reduced demand for offshore marine transportation, processing or storage services would have a material adverse effect on our future growth and could harm our business, results of operations and financial condition.

Because payments under our contracts of affreightment are based on the volume of oil transported, utilization of our shuttle tanker fleet and the success of our shuttle tanker business depends upon continued production from existing or new oil fields it services, which is beyond our control and generally declines naturally over time. Any decrease in the volume of oil transported under contracts of affreightment could adversely affect our business and operating results.

A majority of our shuttle tankers operate under contracts of affreightment. Payments under these contracts of affreightment are based upon the volume of oil transported, which depends upon the level of oil production at the fields we service under the contracts. Oil production levels are affected by several factors, all of which are beyond our control, including: geologic factors, including general declines in production that occur naturally over time; the rate of technical developments in extracting oil and related infrastructure and implementation costs; and operator decisions based on revenue compared to costs from continued operations. Factors that may affect an operator's decision to initiate or continue production include: changes in oil prices; capital budget limitations; the availability of necessary drilling and other governmental permits; the availability of qualified personnel and equipment; the quality of drilling prospects in the area; and regulatory changes. In addition, the volume of oil transported may be adversely affected by extended repairs to oil field installations or suspensions of field operations as a result of oil spills or otherwise.

The rate of oil production at fields we service may decline from existing or future levels, and may be terminated. If such a reduction or termination occurs, the spot market rates, if any, in the conventional oil tanker trades at which we may be able to redeploy the affected shuttle tankers may be lower than the rates previously earned by the vessels under the contracts of affreightment, which would reduce our results of operations and ability to make cash distributions.

The duration of many of our shuttle tanker and FSO contracts is the life of the relevant oil field or is subject to extension by the field operator or vessel charterer. If the oil field no longer produces oil or is abandoned or the contract term is not extended, we will no longer generate revenue under the related contract and will need to seek to redeploy affected vessels.

Many of our shuttle tanker contracts have a "life-of-field" duration, which means that the contract continues until oil production at the field ceases. If production terminates for any reason, we no longer will generate revenue under the related contract. Other shuttle tanker and FSO contracts under which our vessels operate are subject to extensions beyond their initial term. The likelihood of these contracts being extended may be negatively affected by reductions in oil field reserves, low oil prices generally or other factors. If we are unable to promptly redeploy any affected vessels at rates at least equal to those under the contracts, if at all, our operating results will be harmed. Any potential redeployment may not be under long-term contracts, which may affect the stability of our cash flow and our ability to make cash distributions.

The continuation of recent economic conditions, including disruptions in the global credit markets, could adversely affect our results of operations.

The recent economic downturn and crisis in the global financial markets have produced illiquidity in the capital markets, market volatility, heightened exposure to interest rate and credit risks and reduced access to capital markets. If this economic downturn continues, we may face restricted access to the capital markets or secured debt lenders, such as our revolving credit facilities. The decreased access to such resources could have a material adverse effect on our business, financial condition and results of operations.

The recent economic downturn may affect our customers' ability to charter our vessels and pay for our services and may adversely affect our business and results of operations.

The recent economic downturn and crisis in the global financial markets may lead to a decline in our customers' operations or ability to pay for our services, which could result in decreased demand for our vessels and services. Our customer's inability to pay could also result in their default on our current contracts and charters. The decline in the amount of services requested by our customers or their default on our contracts with them could have a material adverse effect on our business, financial condition and results of operations. We cannot determine whether the difficult conditions in the economy and the financial markets will improve or worsen in the near future.

The results of our shuttle tanker operations in the North Sea are subject to seasonal fluctuations.

Due to harsh winter weather conditions, oil field operators in the North Sea typically schedule oil platform and other infrastructure repairs and maintenance during the summer months. Because the North Sea is our primary existing offshore oil market, this seasonal repair and maintenance activity contributes to quarter-to-quarter volatility in our results of operations, as oil production typically is lower in the second and third quarters in this region compared with production in the first and fourth quarters. Because a significant portion of our North Sea shuttle tankers operate under contracts of affreightment, under which revenue is based on the volume of oil transported, the results of these shuttle tanker operations in the North Sea under these contracts generally reflect this seasonal production pattern. When we redeploy affected shuttle tankers as conventional oil tankers while platform maintenance and repairs are conducted, the overall financial results for the North Sea shuttle tanker operations may be negatively affected as the rates in the conventional oil tanker markets at times may be lower than contract of affreightment rates. In addition, we seek to coordinate some of the general drydocking schedule of our fleet with this seasonality, which may result in lower revenues and increased drydocking expenses during the summer months.

Our growth depends on our ability to expand relationships with existing customers and obtain new customers, for which we will face substantial competition.

One of our principal objectives is to enter into additional long-term, fixed-rate time charters and contracts of affreightment. The process of obtaining new long-term time charters and contracts of affreightment is highly competitive and generally involves an intensive screening process and competitive bids, and often extends for several months. Shuttle tanker, FSO and FPSO contracts are awarded based upon a variety of factors relating to the vessel operator, including:

- industry relationships and reputation for customer service and safety;
- experience and quality of ship operations;
- quality, experience and technical capability of the crew;
- relationships with shipyards and the ability to get suitable berths;
- construction management experience, including the ability to obtain on-time delivery of new vessels according to customer specifications;
- willingness to accept operational risks pursuant to the charter, such as allowing termination of the charter for force majeure events; and
- competitiveness of the bid in terms of overall price.

We expect substantial competition for providing services for potential shuttle tanker, FSO and FPSO projects from a number of experienced companies, including state-sponsored entities. OPCO's Aframax conventional tanker business also faces substantial competition from major oil companies, independent owners and operators and other sized tankers. Many of our competitors have significantly greater financial resources than do we, OPCO or Teekay Corporation, which also may compete with us. We anticipate that an increasing number of marine transportation companies — including many with strong reputations and extensive resources and experience — will enter the FSO and FPSO sectors. This increased competition may cause greater price competition for charters. As a result of these factors, we may be unable to expand our relationships with existing customers or to obtain new customers on a profitable basis, if at all, which would have a material adverse effect on our business, results of operations and financial condition and our ability to make cash distributions.

Delays in deliveries of newbuilding vessels or of conversions of existing vessels could harm our operating results.

The delivery of any newbuildings or vessel conversions we may order could be delayed, which would delay our receipt of revenues under the charters or other contracts related to the vessels. In addition, under some charters we may enter into that are related to a newbuilding or conversion, if our delivery of the newbuilding or converted vessel to our customer is delayed, we may be required to pay liquidated damages during the delay. For prolonged delays, the customer may terminate the charter and, in addition to the resulting loss of revenues, we may be responsible for substantial liquidated damages.

The completion and delivery of newbuildings or vessel conversions could be delayed because of:

- quality or engineering problems, the risk of which may be increased with FPSO units due to their technical complexity;
- changes in governmental regulations or maritime self-regulatory organization standards;

- work stoppages or other labor disturbances at the shipyard;
- bankruptcy or other financial crisis of the shipbuilder;
- a backlog of orders at the shipyard;
- political or economic disturbances;
- weather interference or catastrophic event, such as a major earthquake or fire;
- requests for changes to the original vessel specifications;
- shortages of or delays in the receipt of necessary construction materials, such as steel;
- inability to finance the construction or conversion of the vessels; or
- inability to obtain requisite permits or approvals.

If delivery of a vessel is materially delayed, it could adversely affect our results of operations and financial condition and our ability to make cash distributions.

Charter rates for conventional oil tankers may fluctuate substantially over time and may be lower when we are or OPCO is attempting to recharter conventional oil tankers, which could adversely affect operating results. Any changes in charter rates for shuttle tankers or FSO or FPSO units could also adversely affect redeployment opportunities for those vessels.

Our ability to recharter OPCO's conventional oil tankers following expiration of existing time-charter contracts commencing in 2011 and the rates payable upon any renewal or replacement charters will depend upon, among other things, the state of the conventional tanker market. Conventional oil tanker trades are highly competitive and have experienced significant fluctuations in charter rates based on, among other things, oil and vessel demand. For example, an oversupply of conventional oil tankers can significantly reduce their charter rates. There also exists some volatility in charter rates for shuttle tankers and FSO and FPSO units.

Over time, the value of our vessels may decline, which could adversely affect our operating results.

Vessel values for shuttle tankers, conventional oil tankers and FSO and FPSO units can fluctuate substantially over time due to a number of different factors, including:

- prevailing economic conditions in oil and energy markets;
- a substantial or extended decline in demand for oil;
- increases in the supply of vessel capacity; and
- the cost of retrofitting or modifying existing vessels, as a result of technological advances in vessel design or equipment, changes in applicable environmental or other regulations or standards, or otherwise.

If operation of a vessel is not profitable, or if we cannot re-deploy a vessel at attractive rates upon termination of a time charter or contract of affreightment, rather than continue to incur costs to maintain and finance the vessel, we may seek to dispose of it. Our inability to dispose of the vessel at a reasonable value could result in a loss on its sale and adversely affect our results of operations and financial condition. Further, if we determine at any time that a vessel's future useful life and earnings require us to impair its value on our financial statements, we may need to recognize a significant charge against our earnings.

We may be unable to make or realize expected benefits from acquisitions, and implementing our growth strategy through acquisitions may harm our business, financial condition and operating results.

Our growth strategy includes selectively acquiring existing shuttle tankers and FSO and FPSO units or businesses that own or operate these types of vessels. Historically, there have been very few purchases of existing vessels and businesses in the FSO and FPSO segments. Factors that may contribute to a limited number of acquisition opportunities for FSO units and FPSO units in the near term include the relatively small number of independent FSO and FPSO fleet owners. In addition, competition from other companies, many of which have significantly greater financial resources than do we or Teekay Corporation, could reduce our acquisition opportunities or cause us to pay higher prices.

Any acquisition of a vessel or business may not be profitable at or after the time of acquisition and may not generate cash flow sufficient to justify the investment. In addition, our acquisition growth strategy exposes us to risks that may harm our business, financial condition and operating results, including risks that we may:

- fail to realize anticipated benefits, such as new customer relationships, cost-savings or cash flow enhancements;
- be unable to hire, train or retain qualified shore and seafaring personnel to manage and operate our growing business and fleet;
- decrease our liquidity by using a significant portion of available cash or borrowing capacity to finance acquisitions;
- significantly increase our interest expense or financial leverage if we incur additional debt to finance acquisitions;

- incur or assume unanticipated liabilities, losses or costs associated with the business or vessels acquired; or
- incur other significant charges, such as impairment of goodwill or other intangible assets, asset devaluation or restructuring charges.

Unlike newbuildings, existing vessels typically do not carry warranties as to their condition. While we generally inspect existing vessels prior to purchase, such an inspection would normally not provide us with as much knowledge of a vessel's condition as we would possess if it had been built for us and operated by us during its life. Repairs and maintenance costs for existing vessels are difficult to predict and may be substantially higher than for vessels we have operated since they were built. These costs could decrease our cash flow and reduce our liquidity.

Terrorist attacks, piracy, increased hostilities or war could lead to further economic instability, increased costs and disruption of business.

Terrorist attacks, and the current conflicts in Iraq and Afghanistan and other current and future conflicts, may adversely affect our business, operating results, financial condition, and ability to raise capital and future growth. Continuing hostilities in the Middle East may lead to additional armed conflicts or to further acts of terrorism and civil disturbance in the United States or elsewhere, which may contribute further to economic instability and disruption of oil production and distribution, which could result in reduced demand for our services.

In addition, oil facilities, shipyards, vessels, pipelines and oil fields could be targets of future terrorist attacks and our vessels could be targets of pirates or hijackers. Any such attacks could lead to, among other things, bodily injury or loss of life, vessel or other property damage, increased vessel operational costs, including insurance costs, and the inability to transport oil to or from certain locations. Terrorist attacks, war, piracy, hijacking or other events beyond our control that adversely affect the distribution, production or transportation of oil to be shipped by us could entitle customers to terminate the charters and impact the use of shuttle tankers under contracts of affreightment, which would harm our cash flow and business.

Our substantial operations outside the United States expose us to political, governmental and economic instability, which could harm our operations.

Because our operations are primarily conducted outside of the United States, they may be affected by economic, political and governmental conditions in the countries where we engage in business or where our vessels are registered. Any disruption caused by these factors could harm our business, including by reducing the levels of oil exploration, development and production activities in these areas. We derive some of our revenues from shipping oil from politically unstable regions. Conflicts in these regions have included attacks on ships and other efforts to disrupt shipping. Hostilities or other political instability in regions where we operate or where we may operate could have a material adverse effect on the growth of our business, results of operations and financial condition and ability to make cash distributions. In addition, tariffs, trade embargoes and other economic sanctions by the United States or other countries against countries in Southeast Asia or elsewhere as a result of terrorist attacks, hostilities or otherwise may limit trading activities with those countries, which could also harm our business and ability to make cash distributions. Finally, a government could requisition one or more of our vessels, which is most likely during war or national emergency. Any such requisition would cause a loss of the vessel and could harm our cash flow and financial results.

Marine transportation is inherently risky, particularly in the extreme conditions in which many of our vessels operate. An incident involving significant loss of product or environmental contamination by any of our vessels could harm our reputation and business.

Vessels and their cargoes and oil production facilities we service are at risk of being damaged or lost because of events such as:

- marine disasters;
- bad weather;
- mechanical failures;
- grounding, capsizing, fire, explosions and collisions;
- piracy;
- human error; and
- war and terrorism.

Our shuttle tanker fleet primarily operates in the North Sea. Harsh weather conditions in this region (or other regions in which our vessels operate) may increase the risk of collisions, oil spills, or mechanical failures.

An accident involving any of our vessels could result in any of the following:

- death or injury to persons, loss of property or damage to the environment and natural resources;
- delays in the delivery of cargo;
- loss of revenues from charters or contracts of affreightment;
- liabilities or costs to recover any spilled oil or other petroleum products and to restore the eco-system where the spill occurred;
- governmental fines, penalties or restrictions on conducting business;
- higher insurance rates; and

- damage to our reputation and customer relationships generally.

Any of these results could have a material adverse effect on our business, financial condition and operating results. In addition, any damage to, or environmental contamination involving, oil production facilities serviced could suspend that service and result in loss of revenues.

Insurance may be insufficient to cover losses that may occur to our property or result from our operations.

The operation of shuttle tankers, conventional oil tankers and FSO and FPSO units is inherently risky. All risks may not be adequately insured against, and any particular claim may not be paid by insurance. In addition, substantially all of our vessels are not insured against loss of revenues resulting from vessel off-hire time, based on the cost of this insurance compared to our off-hire experience. Any significant off-hire time of our vessels could harm our business, operating results and financial condition. Any claims relating to our operations covered by insurance would be subject to deductibles, and since it is possible that a large number of claims may be brought, the aggregate amount of these deductibles could be material. Certain insurance coverage is maintained through mutual protection and indemnity associations, and as a member of such associations we may be required to make additional payments over and above budgeted premiums if member claims exceed association reserves.

We may be unable to procure adequate insurance coverage at commercially reasonable rates in the future. For example, more stringent environmental regulations have led in the past to increased costs for, and in the future may result in the lack of availability of, insurance against risks of environmental damage or pollution. A catastrophic oil spill or marine disaster could exceed the insurance coverage, which could harm our business, financial condition and operating results. Any uninsured or underinsured loss could harm our business and financial condition. In addition, the insurance may be voidable by the insurers as a result of certain actions, such as vessels failing to maintain certification with applicable maritime self-regulatory organizations.

Changes in the insurance markets attributable to terrorist attacks may also make certain types of insurance more difficult to obtain. In addition, the insurance that may be available may be significantly more expensive than existing coverage.

We may experience operational problems with vessels that reduce revenue and increase costs.

Shuttle tankers are complex and their operation is technically challenging. To the extent we acquire FPSO units, this complexity and challenge will increase. Marine transportation operations are subject to mechanical risks and problems. Operational problems may lead to loss of revenue or higher than anticipated operating expenses or require additional capital expenditures. Any of these results could harm our business, financial condition and operating results.

The offshore shipping and storage industry is subject to substantial environmental and other regulations, which may significantly limit operations or increase expenses.

Our operations are affected by extensive and changing international, national and local environmental protection laws, regulations, treaties and conventions in force in international waters, the jurisdictional waters of the countries in which our vessels operate, as well as the countries of our vessels' registration, including those governing oil spills, discharges to air and water, and the handling and disposal of hazardous substances and wastes. Many of these requirements are designed to reduce the risk of oil spills and other pollution. In addition, we believe that the heightened environmental, quality and security concerns of insurance underwriters, regulators and charterers will lead to additional regulatory requirements, including enhanced risk assessment and security requirements and greater inspection and safety requirements on vessels. We expect to incur substantial expenses in complying with these laws and regulations, including expenses for vessel modifications and changes in operating procedures.

These requirements can affect the resale value or useful lives of our vessels, require a reduction in cargo capacity, ship modifications or operational changes or restrictions, lead to decreased availability of insurance coverage for environmental matters or result in the denial of access to certain jurisdictional waters or ports, or detention in, certain ports. Under local, national and foreign laws, as well as international treaties and conventions, we could incur material liabilities, including cleanup obligations, in the event that there is a release of petroleum or other hazardous substances from our vessels or otherwise in connection with our operations. We could also become subject to personal injury or property damage claims relating to the release of or exposure to hazardous materials associated with our operations. In addition, failure to comply with applicable laws and regulations may result in administrative and civil penalties, criminal sanctions or the suspension or termination of our operations, including, in certain instances, seizure or detention of our vessels.

The United States Oil Pollution Act of 1990 (or OPA 90), for instance, allows for potentially unlimited liability for owners, operators and bareboat charterers for oil pollution and related damages in U.S. waters, which include the U.S. territorial sea and the 200-nautical mile exclusive economic zone around the United States, without regard to fault of such owners, operators and bareboat charterers. OPA 90 expressly permits individual states to impose their own liability regimes with regard to hazardous materials and oil pollution incidents occurring within their boundaries. Coastal states in the United States have enacted pollution prevention liability and response laws, many providing for unlimited liability. Similarly, the International Convention on Civil Liability for Oil Pollution Damage, 1969, as amended, which has been adopted by many countries outside of the United States, imposes liability for oil pollution in international waters. In addition, in complying with OPA 90, regulations of the International Maritime Organization (or IMO), European Union directives and other existing laws and regulations and those that may be adopted, ship-owners may incur significant additional costs in meeting new maintenance and inspection requirements, in developing contingency arrangements for potential spills and in obtaining insurance coverage.

Various jurisdictions and the U.S. Environmental Protection Agency (or EPA) have recently adopted regulations affecting the management of ballast water to prevent the introduction of non-indigenous species considered to be invasive. The EPA's new ballast water treatment obligations will increase the cost of operating our vessels in United States waters.

In addition to international regulations affecting oil tankers generally, countries having jurisdiction over North Sea areas also impose regulatory requirements applicable to operations in those areas. Operators of North Sea oil fields impose further requirements. As a result, we must make significant expenditures for sophisticated equipment, reporting and redundancy systems on our shuttle tankers. Additional regulations and requirements may be adopted or imposed that could limit our ability to do business or further increase the cost of doing business in the North Sea or other regions in which we operate or may operate in the future.

Exposure to currency exchange rate fluctuations results in fluctuations in cash flows and operating results.

We currently are paid partly in Norwegian Kroner under some of our time-charters and contracts of affreightment. In addition, we, OPCO and our and its operating subsidiaries have entered into services agreements with certain subsidiaries of Teekay Corporation pursuant to which those subsidiaries provide to us and OPCO administrative services and to our and OPCO's operating subsidiaries managerial, operational and administrative services. Under the services agreements, the applicable subsidiaries of Teekay Corporation are paid in U.S. dollars for reasonable direct and indirect expenses incurred in providing the services. A substantial majority of those expenses are in Norwegian Kroner. The Teekay Corporation subsidiaries were paid under the services agreements based on a fixed U.S. Dollar/Norwegian Kroner exchange rate until December 31, 2008. The exchange rate is no longer fixed under these agreements, which may result in increased payments by us under the services agreements if the strength of the U.S. Dollar declines relative to the Norwegian Kroner.

The redeployment risk of FPSO units is high given their lack of alternative uses and significant costs.

FPSO units are specialized vessels that have very limited alternative uses and high fixed costs. If we acquire FPSO units and they are not, as a result of contract termination or otherwise, subject to a long-term profitable contract, we may be required to bid for projects at unattractive rates in order to reduce our losses relating to the vessels.

Many seafaring employees are covered by collective bargaining agreements and the failure to renew those agreements or any future labor agreements may disrupt operations and adversely affect our cash flows.

A significant portion of Teekay Corporation's seafarers that crew certain of our vessels and Norwegian-based onshore operational staff that provide services to us are employed under collective bargaining agreements. Teekay Corporation may become subject to additional labor agreements in the future. Teekay Corporation may suffer labor disruptions if relationships deteriorate with the seafarers or the unions that represent them. The collective bargaining agreements may not prevent labor disruptions, particularly when the agreements are being renegotiated. Salaries are typically renegotiated annually or bi-annually for seafarers and annually for onshore operational staff and higher compensation levels will increase our costs of operations. Although these negotiations have not caused labor disruptions in the past, any future labor disruptions could harm our operations and could have a material adverse effect on our business, results of operations and financial condition and ability to make cash distributions.

Teekay Corporation may be unable to attract and retain qualified, skilled employees or crew necessary to operate our business, or may have to pay substantially increased costs for its employees and crew.

Our success depends in large part on Teekay Corporation's ability to attract and retain highly skilled and qualified personnel. In crewing our vessels, we require technically skilled employees with specialized training who can perform physically demanding work. Competition to attract and retain qualified crew members is intense. These costs have continued to increase to date in 2009. If we are not able to increase our rates to compensate for any crew cost increases, our financial condition and results of operations may be adversely affected. Any inability we experience in the future to hire, train and retain a sufficient number of qualified employees could impair our ability to manage, maintain and grow our business.

Teekay Corporation and its affiliates may engage in competition with us.

Teekay Corporation and its affiliates may engage in competition with us. Pursuant to an omnibus agreement we entered into in connection with our initial public offering, Teekay Corporation, Teekay LNG Partners L.P. (NYSE: TGP) and their respective controlled affiliates (other than us, OPCO and its and our subsidiaries) generally have agreed not to engage in, acquire or invest in any business that owns, operates or charters (a) dynamically-positioned shuttle tankers (other than those operating in the conventional oil tanker trade under contracts with a remaining duration of less than three years, excluding extension options), (b) FSO units or (c) FPSO units (collectively *offshore vessels*) without the consent of our general partner. The omnibus agreement, however, allows Teekay Corporation, Teekay LNG Partners L.P. and any of such controlled affiliates to:

- own, operate and charter offshore vessels if the remaining duration of the time charter or contract of affreightment for the vessel, excluding any extension options, is less than three years;
- own, operate and charter offshore vessels and related time charters or contracts of affreightment acquired as part of a business or package of assets and operating or chartering those vessels if a majority of the value of the total assets or business acquired is not attributable to the offshore vessels and related contracts, as determined in good faith by Teekay Corporation's Board of Directors or the conflicts committee of the Board of Directors of Teekay LNG Partners L.P.'s general partner, as applicable; however, if at any time Teekay Corporation or Teekay LNG Partners L.P. completes such an acquisition, it must, within 365 days of the closing of the transaction, offer to sell the offshore vessels and related contracts to us for their fair market value plus any additional tax or other similar costs to Teekay Corporation or Teekay LNG Partners L.P. that would be required to transfer the vessels and contracts to us separately from the acquired business or package of assets; or
- own, operate and charter offshore vessels and related time charters and contracts of affreightment that relate to tender, bid or award for a proposed offshore project that Teekay Corporation or any of its subsidiaries has submitted or received hereafter submits or receives; however, at least 365 days after the delivery date of any such offshore vessel, Teekay Corporation must offer to sell the vessel and related time charter or contract of affreightment to us, with the vessel valued (a) for newbuildings originally contracted by Teekay Corporation, at its "fully-built-up cost" (which represents the aggregate expenditures incurred (or to be incurred prior to delivery to us) by Teekay Corporation to acquire, construct and/or convert and bring such offshore vessel to the condition and location necessary for our intended use, plus project development costs for completed projects and projects that were not completed but, if completed, would have been subject to an offer to us) and (b) for any other vessels, Teekay Corporation's cost to acquire a newbuilding from a third party or the fair market value of an existing vessel, as applicable, plus in each case any subsequent expenditures that would be included in the "fully-built-up cost" of converting the vessel prior to delivery to us.

If we decline the offer to purchase the offshore vessels and time charters described above, Teekay Corporation or Teekay LNG Partners L.P., as applicable, may own and operate the offshore vessels, but may not expand that portion of its business.

In addition, pursuant to the omnibus agreement, Teekay Corporation, Teekay LNG Partners L.P. and any of their respective controlled affiliates (other than us and our subsidiaries) may:

- acquire, operate and charter offshore vessels and related time charters and contracts of affreightment if our general partner has previously advised Teekay Corporation or Teekay LNG Partners L.P. that our general partner's Board of Directors has elected, with the approval of its conflicts committee, not to cause us or our controlled affiliates to acquire or operate the vessels and related time charters and contracts of affreightment;
- acquire up to a 9.9% equity ownership, voting or profit participation interest in any publicly-traded company that engages in, acquires or invests in any business that owns or operates or charters offshore vessels and related time charters and contracts of affreightment;
- provide ship management services relating to owning, operating or chartering offshore vessels and related time charters and contracts of affreightment; or
- own a limited partner interest in OPCO or own shares of Teekay Petrojarl ASA (formally Petrojarl ASA and referred to herein as *Petrojarl*).

Teekay Corporation acquired 100% of Petrojarl on July 9, 2008 and is required to offer to us certain of Petrojarl's fleet by July 9, 2009 and to the extent any such joint venture projects arise, any of Petrojarl's interests in joint venture projects with Teekay Corporation.

If there is a change of control of Teekay Corporation or of the general partner of Teekay LNG Partners L.P., the non-competition provisions of the omnibus agreement may terminate, which termination could have a material adverse effect on our business, results of operations and financial condition and our ability to make cash distributions.

Our general partner and its other affiliates own a controlling interest in us and have conflicts of interest and limited fiduciary duties, which may permit them to favor their own interests to those of unitholders.

Teekay Corporation indirectly owns the 2.0% general partner interest and a 47.99% limited partner interest in us and owns and controls our general partner, which controls us. Although our general partner has a fiduciary duty to manage us in a manner beneficial to us and our unitholders, the directors and officers of our general partner have a fiduciary duty to manage our general partner in a manner beneficial to Teekay Corporation. Furthermore, certain directors and officers of our general partner are directors or officers of affiliates of our general partner. Conflicts of interest may arise between Teekay Corporation and its affiliates, including our general partner, on the one hand, and us and our unitholders, on the other hand. As a result of these conflicts, our general partner may favor its own interests and the interests of its affiliates over the interests of our unitholders. These conflicts include, among others, the following situations:

- neither our partnership agreement nor any other agreement requires Teekay Corporation or its affiliates (other than our general partner) to pursue a business strategy that favors us or utilizes our assets, and Teekay Corporation's officers and directors have a fiduciary duty to make decisions in the best interests of the stockholders of Teekay Corporation, which may be contrary to our interests;
- the Chief Executive Officer and Chief Financial Officer and three of the directors of our general partner also serve as executive officers or directors of Teekay Corporation and the general partner of Teekay LNG Partners L.P.;
- our general partner is allowed to take into account the interests of parties other than us, such as Teekay Corporation, in resolving conflicts of interest, which has the effect of limiting its fiduciary duty to our unitholders;
- our general partner has limited its liability and reduced its fiduciary duties under the laws of the Marshall Islands, while also restricting the remedies available to our unitholders and unitholders are treated as having agreed to the modified standard of fiduciary duties and to certain actions that may be taken by our general partner, all as set forth in our partnership agreement;
- our general partner determines the amount and timing of our asset purchases and sales, capital expenditures, borrowings, issuances of additional partnership securities and reserves, each of which can affect the amount of cash that is available for distribution to our unitholders;
- in some instances, our general partner may cause us to borrow funds in order to permit the payment of cash distributions, even if the purpose or effect of the borrowing is to make a distribution on the subordinated units or to make incentive distributions (in each case to affiliates of Teekay Corporation) or to accelerate the expiration of the subordination period relating to our subordinated units held by Teekay Corporation;
- our general partner determines which costs incurred by it and its affiliates are reimbursable by us;
- our partnership agreement does not restrict our general partner from causing us to pay it or its affiliates for any services rendered to us on terms that are fair and reasonable or entering into additional contractual arrangements with any of these entities on our behalf;
- our general partner intends to limit its liability regarding our contractual and other obligations;
- our general partner may exercise its right to call and purchase common units if it and its affiliates own more than 80.0% of our common units;
- our general partner controls the enforcement of obligations owed to us by it and its affiliates; and
- our general partner decides whether to retain separate counsel, accountants or others to perform services for us.

Although we control OPCO through our ownership of its general partner, OPCO's general partner owes fiduciary duties to OPCO and OPCO's other partner, Teekay Corporation, which may conflict with the interests of us and our unitholders.

Conflicts of interest may arise as a result of the relationships between us and our unitholders, on the one hand, and OPCO, its general partner and its other limited partner, Teekay Corporation, on the other hand. Teekay Corporation owns a 49.0% limited partner interest in OPCO and controls our general partner, which appoints the directors of OPCO's general partner. The directors and officers of OPCO's general partner have fiduciary duties to manage OPCO in a manner beneficial to us, as such general partner's owner. At the same time, OPCO's general partner has a fiduciary duty to manage OPCO in a manner beneficial to OPCO's limited partners, including Teekay Corporation. The Board of Directors of our general

partner may resolve any such conflict and has broad latitude to consider the interests of all parties to the conflict. The resolution of these conflicts may not be in the best interest of us or our unitholders.

For example, conflicts of interest may arise in the following situations:

- the allocation of shared overhead expenses to OPCO and us;
- the interpretation and enforcement of contractual obligations between us and our affiliates, on the one hand, and OPCO or its subsidiaries, on the other hand;
- the determination and timing of the amount of cash to be distributed to OPCO's partners and the amount of cash to be reserved for the future conduct of OPCO's business;
- the decision as to whether OPCO should make asset or business acquisitions or dispositions, and on what terms;
- the determination of the amount and timing of OPCO's capital expenditures;
- the determination of whether OPCO should use cash on hand, borrow funds or issue equity to raise cash to finance maintenance or expansion capital projects, repay indebtedness, meet working capital needs or otherwise; and
- any decision we make to engage in business activities independent of, or in competition with, OPCO.

The fiduciary duties of the officers and directors of our general partner may conflict with those of the officers and directors of OPCO's general partner.

Our general partner's officers and directors have fiduciary duties to manage our business in a manner beneficial to us and our partners. However, the Chief Executive Officer and Chief Financial Officer and all of the non-independent directors of our general partner also serve as executive officers or directors of OPCO's general partner and of Teekay Corporation and the general partner of Teekay LNG Partners L.P., and, as a result, have fiduciary duties, among others, to manage the business of OPCO in a manner beneficial to OPCO and its partners, including Teekay Corporation. Consequently, these officers and directors may encounter situations in which their fiduciary obligations to OPCO, Teekay Corporation or Teekay LNG Partners L.P., on one hand, and us, on the other hand, are in conflict. The resolution of these conflicts may not always be in the best interest of us or our unitholders.

Tax Risks

In addition to the following risk factors, you should read Item 4E. "Taxation of the Partnership" and Item 10. "Taxation" for a more complete discussion of the expected material U.S. federal and non-U.S. income tax considerations relating to us and the ownership and disposition of our Common Units.

U.S. tax authorities could treat us as a "passive foreign investment company," which could have adverse U.S. federal income tax consequences to U.S. holders.

A foreign entity taxed as a corporation for U.S. federal income tax purposes will be treated as a "passive foreign investment company" (or PFIC), for U.S. federal income tax purposes if at least 75.0% of its gross income for any taxable year consists of certain types of "passive income," or at least 50.0% of the average value of the entity's assets produce or are held for the production of those types of "passive income." For purposes of these tests, "passive income" includes dividends, interest, and gains from the sale or exchange of investment property and rents and royalties other than rents and royalties that are received from unrelated parties in connection with the active conduct of a trade or business. For purposes of these tests, income derived from the performance of services does not constitute "passive income." We do not believe that our existing operations would cause us to be deemed a PFIC with respect to any taxable year, as we treat the gross income we derive from our time and voyage charters and our contracts of affreightment as services income, rather than rental income.

There is, however, no direct legal authority under the PFIC rules addressing our method of operation and, therefore, no assurance can be given that the IRS will accept this position or that we would not constitute a PFIC for any future taxable year if there were to be changes in our assets, income or operations. Moreover, a recent decision of the United States Court of Appeals for the Fifth Circuit in *Tidewater Inc. v. United States*, No. 08-30268 (5th Cir. Apr. 13, 2009) held that income derived from certain time chartering activities should be treated as rental income rather than services income. However, the issues in this case arose under the foreign sales corporation rules of the U.S. Internal Revenue Code or 1986, as amended (or the *Code*) and did not concern the PFIC rules. In addition, the court's ruling was contrary to the position of the U.S. Internal Revenue Service (or *IRS*) that the time charter income should be treated as services income. As a result, it is uncertain whether the principles of the *Tidewater* decision would be applicable to our operations. However, if the principles of the *Tidewater* decision were applicable to our operations, we likely would be treated as a PFIC.

If the IRS were to find that we are or have been a PFIC for any taxable year, U.S. unitholders will face adverse U.S. federal income tax consequences. Under the PFIC rules, unless those unitholders make certain elections available under the Code, such unitholders would be taxable at ordinary income tax rates rather than the preferential 15.0% tax rate on our dividends, and would be liable to pay tax at ordinary income tax rates plus interest upon certain distributions and upon any gain from the disposition of our common units, as if such distribution or gain had been recognized ratably over the unitholder's holding period. Please read Item 10. "Additional Information—Material U.S. Federal Income Tax Considerations—U.S. Federal Income Taxation of U.S. Holders—Consequences of Possible PFIC Classification."

The preferential tax rates applicable to qualified dividend income are temporary, and the absence of legislation extending the term would cause our dividends to be taxed at ordinary graduated tax rates.

Certain of our distributions may be treated as qualified dividend income eligible for preferential rates of U.S. federal income tax to U.S. individual unitholders (and certain other U.S. unitholders). In the absence of legislation extending the term for these preferential tax rates or providing for some other treatment, all dividends received by such U.S. taxpayers in tax years beginning on January 1, 2011 or later will be taxed at ordinary graduated

tax rates. Please read Item 10. "Additional Information—Material U.S. Federal Income Tax Considerations—U.S. Federal Income Taxation of U.S. Holders—Distributions."

We may be subject to taxes, which reduces our Cash Available for Distribution to you.

As a result of an offering of our common units in 2008, Teekay Corporation indirectly owns less than 50.0% of our outstanding units and, depending upon the valuation of the general partner interest Teekay Corporation indirectly owns in us, may own 50.0% or less of the value of us. In the event Teekay Corporation does not indirectly own more than 50.0% of the value of our outstanding equity interests for more than half of the days in a given year, we generally will not satisfy the requirements of the exemption from U.S. taxation under Section 883 of the Code for such year and our U.S. source income will be subject to taxation under Section 887 of the Code. The amount of such tax will depend upon the amount of income we earn from voyages into or out of the United States, which is not within our complete control. Please read Item 4E. "Taxation of the Partnership—United States Taxation—The Section 883 Exemption".

Item 4. Information on the Partnership

A. Overview, History and Development

Overview and History

We are an international provider of marine transportation and storage services to the offshore oil industry. We were formed as a Marshall Islands limited partnership in August 2006 by Teekay Corporation (NYSE: TK), a leading provider of marine services to the global oil and natural gas industries, to further develop its operations in the offshore market. We plan to leverage the expertise, relationships and reputation of Teekay Corporation and our controlled affiliates to pursue growth opportunities in this market. As of June 1, 2009, Teekay Corporation, which owns and controls our general partner, owned a 47.99% limited partner interest in us.

We currently own a 50.99% interest in Teekay Offshore Operating L.P. (or *OPCO*) and control its general partner; Teekay Corporation owns a 49% interest in *OPCO*. *OPCO* owns and operates the world's largest fleet of shuttle tankers, in addition to floating storage and offtake (or *FSO*) units and double-hull conventional oil tankers. We acquired from Teekay Corporation an initial ownership interest in connection with our initial public offering in December 2006. In June 2008 we acquired from Teekay Corporation an additional 25% limited partner interest in *OPCO*.

In March 2008, we acquired directly from Teekay Corporation two conventional tanker units, the *SPT Explorer* and *SPT Navigator*, which operate under 10-year fixed-rate, time-charter to Skaugen Petro Trans Inc., Teekay Corporation's 50%-owned joint venture (or *Skaugen PetroTrans*).

As of June 1, 2009, our fleet consisted of:

- **Shuttle Tankers.** Our shuttle tanker fleet consists of 37 vessels that operate under fixed-rate contracts of affreightment, time charters and bareboat charters. Of the 37 shuttle tankers, 25 are owned by *OPCO* (including 5 through 50% owned subsidiaries), 10 are chartered-in by *OPCO* and 2 are owned by us (including one through a 50% owned subsidiary). All of these shuttle tankers provide transportation services to energy companies, primarily in the North Sea and Brazil. The majority of the contracts of affreightment volumes are life-of-field, which have an estimated weighted-average remaining life of approximately 16 years. The time charters and bareboat charters have an average remaining contract term of approximately 5 years. As of June 1, 2009, our shuttle tankers, which had a total cargo capacity of approximately 4.5 million deadweight tonnes (or *dwt*), represented approximately 57% of the total tonnage of the world shuttle tanker fleet.
- **Conventional Tankers.** *OPCO* has a fleet of 11 Aframax conventional crude oil tankers, 9 of which operate under fixed-rate time charters with Teekay Corporation. The remaining 2 vessels, which have additional equipment for lightering, operate under fixed-rate bareboat charters with Skaugen PetroTrans,. The average remaining term on these contracts is approximately 7 years. As of June 1, 2009, our conventional tankers had a total cargo capacity of approximately 1.1 million *dwt*.
- **FSO Units.** We have a fleet of five *FSO* units. All of the *FSO* units operate under fixed-rate contracts, with an average remaining term of approximately 4 years. As of June 1, 2009, our *FSO* units had a total cargo capacity of approximately 0.6 million *dwt*.

We were formed under the laws of the Republic of The Marshall Islands as Teekay Offshore Partners L.P. and maintain our principal executive headquarters at 4th Floor, Belvedere Building, 69 Pitts Bay Road, Hamilton, HM 08, Bermuda. Our telephone number at such address is (441) 298-2530. Our principal operating office is located at Suite 2000, Bentall 5, 550 Burrard Street, Vancouver, British Columbia, Canada, V6C 2K2. Our telephone number at such address is (604) 683-3529.

Potential Additional Shuttle Tanker, FSO and FPSO Projects

Pursuant to an omnibus agreement we entered into in connection with our initial public offering in 2006, Teekay Corporation is obligated to offer us certain shuttle tankers, *FSO* units, and *FPSO* units it may acquire in the future, provided the vessels are servicing contracts in excess of three years in length.

Teekay Corporation has ordered four Aframax shuttle tanker newbuildings, which are scheduled to deliver in 2010 and 2011, for a total delivered cost of approximately \$463.3 million. It is anticipated that these vessels will be offered to us and will be used to service either new long-term, fixed-rate contracts Teekay Corporation may be awarded prior to delivery of the vessels or *OPCO*'s contracts-of-affreightment in the North Sea.

The omnibus agreement also obligates Teekay Corporation to offer to us (a) its interest in certain future *FPSO* and *FSO* projects it may undertake through its 50%-owned joint venture with Teekay Petrojarl ASA (or *Teekay Petrojarl*) and (b) prior to July 9, 2009, existing *FPSO* units of Teekay Petrojarl that are servicing contracts in excess of three years in length. Please see Item 7 – Major Unitholders and Related Party Transactions.

B. Business Overview

Shuttle Tanker Segment

A shuttle tanker is a specialized ship designed to transport crude oil and condensates from offshore oil field installations to onshore terminals and refineries. Shuttle tankers are equipped with sophisticated loading systems and dynamic positioning systems that allow the vessels to load cargo safely and reliably from oil field installations, even in harsh weather conditions. Shuttle tankers were developed in the North Sea as an alternative to pipelines. The first cargo from an offshore field in the North Sea was shipped in 1977, and the first dynamically-positioned shuttle tankers were introduced in the early 1980s. Shuttle tankers are often described as “floating pipelines” because these vessels typically shuttle oil from offshore installations to onshore facilities in much the same way a pipeline would transport oil along the ocean floor.

Our shuttle tankers are primarily subject to long-term, fixed-rate time-charter contracts for a specific offshore oil field or under contracts of affreightment for various fields. The number of voyages performed under these contracts of affreightment normally depends upon the oil production of each field. Competition for charters is based primarily upon price, availability, the size, technical sophistication, age and condition of the vessel and the reputation of the vessel’s manager. Technical sophistication of the vessel is especially important in harsh operating environments such as the North Sea. Although the size of the world shuttle tanker fleet has been relatively unchanged in recent years, conventional tankers could be converted into shuttle tankers by adding specialized equipment to meet customer requirements. Shuttle tanker demand may also be affected by the possible substitution of sub-sea pipelines to transport oil from offshore production platforms.

As of June 1, 2009, there were approximately 75 vessels in the world shuttle tanker fleet (including newbuildings), the majority of which operate in the North Sea. Shuttle tankers also operate in Brazil, Canada, Russia and Australia. As of June 1, 2009, we owned 27 shuttle tankers and chartered-in an additional 8 shuttle tankers. Other shuttle tanker owners in the North Sea include Knutsen OAS Shipping AS, JJ Uglund Group, Mowinckel, Chevron and ConocoPhillips, which as of June 1, 2009 controlled fleets of 1 to 10 shuttle tankers each. We believe that we have significant competitive advantages in the shuttle tanker market as a result of the quality, type and dimensions of our vessels combined with our market share in the North Sea.

The following tables provide additional information about our shuttle tankers as of June 1, 2009:

Vessel	Capacity (dwt)	Built	Ownership	Positioning system	Operating Region	Contract Type (1)	Charterer	Remaining Term
Navion Hispania	126,700	1999	100%	DP2	North Sea	CoA	StatoilHydro, Chevron, Hess, Marathon Oil, ExxonMobil, ENI, MTDA, Draugen Transport, BP, ConocoPhillips, Shell, Total, Talisman, Nexen, DONG, Petrofac, Idemitsu and Lundin (6)	
Navion Oceania	126,300	1999	100%	DP2	North Sea	CoA		
Navion Anglia	126,300	1999	100%	DP2	North Sea	CoA		
Navion Scandia	126,700	1998	100%	DP2	North Sea	CoA		
Navion Britannia (2)	124,200	1998	100%	DP2	North Sea	CoA		
Navion Norvegia (2)	130,600	1995	100%	DP	North Sea	CoA		
Navion Europa (2)	130,300	1995	100%	DP	North Sea	CoA		
Navion Fennia (2)	95,200	1992	100%	DP	North Sea	CoA		
Grena	148,000	2003	In-chartered (until 2013) (3)	DP2	North Sea	CoA		
Navion Oslo	100,300	2001	100%	DP2	North Sea	CoA		
Nordic Torinita	106,800	1992	100%	DP2	North Sea	CoA		
Sallie Knutsen	153,600	1999	In-chartered (until 2015)	DP2	North Sea	CoA		
Karen Knutsen	153,600	1999	In-chartered (until 2013)	DP2	North Sea	CoA		
Elisabeth Knutsen	124,700	1997	In-chartered (until 2009)	DP2	North Sea	CoA		
Aberdeen	87,000	1996	In-chartered (until 2009)	DP	North Sea	CoA		
Randgrid (2)	124,500	1995	In-chartered (until 2014) (4)	DP	North Sea	CoA		
Tordis Knutsen	123,800	1993	In-chartered (unit 2010)	DP	North Sea	CoA		
Navion Akarita	107,200	1991	Lease (until 2012) (5)	DP	North Sea	CoA	Majority of volumes are life-of-field	
Stena Sirita	127,400	1999	50% (7)	DP2	North Sea	Time charter	ExxonMobil (8)	1.5 years
Navion Clipper	78,200	1993	100%	DP	Brazil	Time charter	Petrobras	1 year
Nordic Marita	103,900	1999	100%	DP	Brazil	Time charter	Petrobras	1.5 years
Stena Natalita	108,000	2001	50% (7)	DP2	North Sea	Time charter	ExxonMobil (8)	1.5 years
Stena Alexita	127,400	1998	50% (7)	DP2	North Sea	Time charter	ExxonMobil (8)	1 year
Nordic Svenita	106,500	1997	100%	DP	Brazil	Time charter	Petrobras	0.3 year
Nordic Savonita	108,100	1992	100%	DP	Brazil	Time charter	Petrobras	1.5 year
Basker Spirit	97,000	1992	100%	DP	Australia	Time charter	RocOil (8)	1.5 year
Navion Stavanger	147,500	2003	100%	DP2	Brazil	Bareboat	Petrobras (9)	10 years
Nordic Spirit	151,300	2001	100%	DP	Brazil	Bareboat	Petrobras (9)	9 years
Stena Spirit	151,300	2001	50% (7)	DP	Brazil	Bareboat	Petrobras (9)	9 years
Nordic Brasilia	151,300	2004	100%	DP	Brazil	Bareboat	Petrobras (9)	9 years
Nordic Rio	151,300	2004	50% (7)	DP	Brazil	Bareboat	Petrobras (9)	9 years
Navion Bergen	105,600	2000	100%	DP2	Brazil	Bareboat	Petrobras (9)	12 years
Navion Gothenburg	152,200	2006	50% (7)	DP2	Brazil	Bareboat	Petrobras (9)	13 years
Petroatlantic	92,900	2003	100%	DP2	North Sea	Bareboat	Petrojarl/BP (9)	1 year
Petronordic	92,900	2002	100%	DP2	North Sea	Bareboat	Petrojarl/BP (9)	1 year
Total capacity	<u>4,268,600</u>							

- (1) “CoA” refers to contracts of affreightment.
- (2) The vessel is capable of loading from a submerged turret loading buoy.
- (3) OPCO has options to extend the time charter or purchase the vessel.
- (4) The time charter period is linked to the term of the transportation service agreement for the Heidrun field on the Norwegian continental shelf, which term is in turn linked to the production level at the field.

- (5) OPCO has options to extend the bareboat lease.
- (6) Not all of the contracts of affreightment customers utilize every ship in the contract of affreightment fleet.
- (7) Owned through a 50% owned subsidiary. The parties share in the profits and losses of the subsidiary in proportion to each party's relative capital contributions. Teekay Corporation subsidiaries provide operational services for these vessels.
- (8) Charterer has an option to extend the time charter.
- (9) Charterer has the right to purchase the vessel at end of the bareboat charter.

On the Norwegian continental shelf, regulations have been imposed on the operators of offshore fields related to vaporized crude oil that is formed and emitted during loading operations and which is commonly referred to as "VOC." To assist the oil companies in their efforts to meet the regulations on VOC emissions from shuttle tankers, OPCO and Teekay Corporation have played an active role in establishing a unique co-operation among all of the approximately 26 owners of offshore fields in the Norwegian sector. The purpose of the co-operation is to implement VOC recovery systems on selected shuttle tankers and to ensure a high degree of VOC recovery at a minimum cost followed by joint reporting to the authorities. Currently, there are 12 VOC plants installed aboard shuttle tankers operated or owned by OPCO. The oil companies that participate in the co-operation have engaged OPCO to undertake the day-to-day administration, technical follow-up and handling of payments through a dedicated clearing house function.

During 2008, approximately 74% of our net voyage revenues from continuing operations were earned by the vessels in the shuttle tanker segment, compared to approximately 75% in 2007 and 82% in 2006. Please read Item 5 – Operating and Financial Review and Prospects: Results of Operations.

Historically, the utilization of shuttle tankers in the North Sea is higher in the winter months, as favorable weather conditions in the summer months provide opportunities for repairs and maintenance to our vessels and to the offshore oil platforms. Downtime for repairs and maintenance generally reduces oil production and, thus, transportation requirements.

Conventional Tanker Segment

Conventional oil tankers are used primarily for transcontinental seaborne transportation of oil. Conventional oil tankers are operated by both major oil companies (including state-owned companies) that generally operate captive fleets, and independent operators that charter out their vessels for voyage or time charter use. Most conventional oil tankers controlled by independent fleet operators are hired for one or a few voyages at a time at fluctuating market rates based on the existing tanker supply and demand. These charter rates are extremely sensitive to this balance of supply and demand, and small changes in tanker utilization have historically led to relatively large changes in short-term rates. Long-term, fixed-rate charters for crude oil transportation, such as those applicable to OPCO's conventional tanker fleet, are less typical in the industry. As used in this discussion, "conventional" oil tankers exclude those vessels that can carry dry bulk and ore, tankers that currently are used for storage purposes and shuttle tankers.

Oil tanker demand is a function of several factors, including the location of oil production, refining and consumption and world oil demand and supply. Tanker demand is based on the amount of crude oil transported in tankers and the distance over which the oil is transported. The distance over which oil is transported is determined by seaborne trading and distribution patterns, which are principally influenced by the relative advantages of the various sources of production and locations of consumption.

The majority of crude oil tankers ranges in size from approximately 80,000 to approximately 320,000 dwt. Aframax tankers are the mid-size of the various primary oil tanker types, typically sized from 80,000 to 119,999 dwt. As of June 1, 2009, the world Aframax tanker fleet consisted of approximately 804 vessels, of which 613 crude tankers and 191 coated tankers are termed conventional tankers. As of June 1, 2009, there were approximately 200 conventional Aframax newbuildings on order for delivery through 2011. Delivery of a vessel typically occurs within three to four years after ordering.

As of June 1, 2009, our Aframax conventional crude oil tankers had an average age of approximately 10.8 years, compared to the average age of 8.8 years for the world Aframax conventional tanker fleet. New Aframax tankers generally are expected to have a lifespan of approximately 25 to 30 years, based on estimated hull fatigue life. However, United States and international regulations require the phase-out of double-hulled vessels by 25 years. All of our Aframax tankers are double-hulled.

We do not expect to compete for deployment of any of our Aframax vessels until the first charter is scheduled to end in December 2011. The shuttle tankers in OPCO's contract of affreightment fleet may operate in the conventional spot market during downtime or maintenance periods for oil field installations or otherwise, which provides greater capacity utilization for the fleet.

The following table provides additional information about our conventional tankers as of June 1, 2009:

Vessel	Capacity (dwt)	Built	Ownership	Contract Type	Charterer	Remaining Term
SPT Explorer (1)	106,000	2008	100%	Bareboat	Skaugen PT	10 years
SPT Navigator (1)	106,000	2008	100%	Bareboat	Skaugen PT	10 years
Kilimanjaro Spirit (2)	115,000	2004	100%	Time charter	Teekay	10 years
Fuji Spirit (2)	106,300	2003	100%	Time charter	Teekay	10 years
Hamane Spirit (2)	105,200	1997	100%	Time charter	Teekay	7 years
Poul Spirit (2)	105,300	1995	100%	Time charter	Teekay	6 years
Gotland Spirit (2)	95,300	1995	100%	Time charter	Teekay	6 years
Torben Spirit (2)	98,600	1994	100%	Time charter	Teekay	4 years

Scotia Spirit (3)	95,000	1992	100%	Time charter	Teekay	3 years
Leyte Spirit (2)	98,700	1992	100%	Time charter	Teekay	3 years
Luzon Spirit (2)	<u>98,600</u>	1992	100%	Time charter	Teekay	3 years
Total capacity	<u><u>1,130,000</u></u>					

- (1) Charterer has options to extend each bareboat charter for periods of two years, two years and one year for a total of five years after the initial term.
- (2) Charterer has options to extend each time charter on an annual basis for a total of five years after the initial term. Charterer also has the right to purchase the vessel beginning on the third anniversary of the contract at a specified price.
- (3) This vessel has been equipped with FSO equipment and OPCO can terminate the charter upon 30-days notice if it has arranged an FSO project for the vessel.

During 2008, approximately 15% of our net voyage revenues from continuing operations were earned by the vessels in the conventional tanker segment, compared to approximately 16% in 2007 and 12% in 2006. Please read Item 5 – Operating and Financial Review and Prospects: Results of Operations.

FSO Segment

FSO units provide on-site storage for oil field installations that have no storage facilities or that require supplemental storage. An FSO unit is generally used in combination with a jacked-up fixed production system, floating production systems that do not have sufficient storage facilities or as supplemental storage for fixed platform systems, which generally have some on-board storage capacity. An FSO unit is usually of similar design to a conventional tanker, but has specialized loading and offtake systems required by field operators or regulators. FSO units are moored to the seabed at a safe distance from a field installation and receive the cargo from the production facility via a dedicated loading system. An FSO unit is also equipped with an export system that transfers cargo to shuttle or conventional tankers. Depending on the selected mooring arrangement and where they are located, FSO units may or may not have any propulsion systems. FSO units are usually conversions of older single-hull conventional oil tankers. These conversions, which include installation of a loading and offtake system and hull refurbishment, can generally extend the lifespan of a vessel as an FSO unit by up to 20 years over the normal conventional tanker lifespan of 25 years.

Our FSO units are generally placed on long-term, fixed-rate time charters or bareboat charters as an integrated part of the field development plan, which provides more stable cash flow to us.

As of June 1, 2009, there were approximately 88 FSO units operating and 6 FSO units on order in the world fleet, and we had 5 FSO units. The major markets for FSO units are Asia, the Middle East, West Africa, South America and the North Sea. Our primary competitors in the FSO market are conventional tanker owners, who have access to tankers available for conversion, and oil field services companies and oil field engineering and construction companies who compete in the floating production system market. Competition in the FSO market is primarily based on price, expertise in FSO operations, management of FSO conversions and relationships with shipyards, as well as the ability to access vessels for conversion that meet customer specifications.

The following table provides additional information about our FSO units as of June 1, 2009:

Vessel	Capacity (dwt)	Built	Ownership	Field name and location	Contract Type	Charterer	Remaining Term
Pattani Spirit	113,800	1988	100%	Platong, Thailand	Bareboat	Teekay	5 years (1)
Nordic Apollo	129,000	1978	89%	Banff, U.K.	Bareboat	Teekay	6 years (2)
Navion Saga	149,000	1991	100%	Volve, Norway	Time charter	StatoilHydro	1 years (3)
Karratha Spirit	106,600	1988	100%	Legendre, Australia	Time charter	Apache	2 years (3)
Dampier Spirit	<u>106,700</u>	1987	100%	Stag, Australia	Time charter	Apache	5 years (3)
Total capacity	<u><u>605,100</u></u>						

- (1) This vessel is on a back-to-back charter between Teekay and Unocol for a remaining term of five years.
- (2) Charterer is required to charter the vessel for as long as a specified FPSO unit, the *Petrojarl Banff*, produces the Banff field in the North Sea, which could extend to 2014 depending on the field operator.
- (3) Charterer has option to extend the time charter after the initial fixed period.

During 2008 approximately 10% of our net voyage revenues from continuing operations were earned by the vessels in the FSO segment, compared to 9% in 2007 and 6% in 2006. Please read Item 5 – Operating and Financial Review and Prospects: Results of Operations.

Business Strategies

Our primary business objective is to increase distributions per unit by executing the following strategies:

- **Expand global operations in high growth regions.** We seek to expand our shuttle tanker and FSO unit operations into growing offshore markets such as Brazil and Australia. In addition, we intend to pursue opportunities in new markets such as Arctic Russia, Eastern Canada, the Gulf of Mexico, Asia and Africa.

- **Pursue opportunities in the FPSO sector.** We believe that Teekay Corporation's ownership of Petrojarl will enable us to competitively pursue FPSO projects anywhere in the world by combining Petrojarl's engineering and operational expertise with Teekay Corporation's global marketing organization and extensive customer and shipyard relationships.
- **Acquire additional vessels on long-term, fixed-rate contracts.** We intend to continue acquiring shuttle tankers and FSO units with long-term contracts, rather than ordering vessels on a speculative basis, and we intend to follow this same practice in acquiring FPSO units. We believe this approach facilitates the financing of new vessels based on their anticipated future revenues and ensures that new vessels will be employed upon acquisition, which should stabilize cash flows. Additionally, we anticipate growing by acquiring additional limited partner interests in OPCO that Teekay Corporation may offer us in the future.
- **Provide superior customer service by maintaining high reliability, safety, environmental and quality standards.** Energy companies seek transportation partners that have a reputation for high reliability, safety, environmental and quality standards. We intend to leverage OPCO's and Teekay Corporation's operational expertise and customer relationships to further expand a sustainable competitive advantage with consistent delivery of superior customer service.
- **Manage our conventional tanker fleet to provide stable cash flows.** We believe the fixed-rate time charters for these tankers will provide stable cash flows during their terms and a source of funding for expanding offshore operations. Depending on prevailing market conditions during and at the end of each existing charter, we may seek to extend the charter, enter into a new charter, operate the vessel on the spot market or sell the vessel, in an effort to maximize returns on the conventional fleet while managing residual risk.

Customers

We provide marine transportation and storage services to energy and oil service companies or their affiliates. Our most important customer measured by annual voyage revenue excluding Teekay Corporation, is StatoilHydro ASA, which is Norway's largest energy company and one of the world's largest producers of crude oil. StatoilHydro created the shuttle tanker industry beginning in the late 1970s and developed the current operating model in the North Sea. StatoilHydro chose Teekay Corporation to purchase its shuttle tanker operations in 2003, and Teekay Corporation and we continue to have a close working relationship with StatoilHydro.

StatoilHydro, Teekay Corporation and Petrobras Transporte S.A. accounted for approximately 37%, 21% and 13%, respectively, of our consolidated voyage revenues from continuing operations during the year ended December 31, 2008. StatoilHydro, Teekay Corporation and Petrobras Transporte S.A. accounted for approximately 39%, 20% and 13%, respectively, of our consolidated voyage revenues from continuing operations during 2007. Teekay Corporation and StatoilHydro ASA accounted for approximately 12% and 30%, respectively, of consolidated voyage revenues from continuing operations during 2006. No other customer accounted for 10% or more of revenues during any of these periods.

Safety, Management of Ship Operations and Administration

Safety and environmental compliance are our top operational priorities. We operate our vessels in a manner intended to protect the safety and health of our employees, the general public and the environment. We seek to manage the risks inherent in our business and are committed to eliminating incidents that threaten the safety and integrity of our vessels. In 2007 Teekay Corporation introduced a behavior-based safety program called "Safety in Action" to improve the safety culture in our fleet. We are also committed to reducing our emissions and waste generation. In 2008, we introduced the Quality Assurance and Training Officers (or QATO) Program to conduct rigorous internal audits of our processes and provide our seafarers with onboard training.

Key performance indicators facilitate regular monitoring of our operational performance. Targets are set on an annual basis to drive continuous improvement, and indicators are reviewed monthly to determine if remedial action is necessary to reach the targets.

Teekay Corporation, through certain of its subsidiaries, assists our operating subsidiaries in managing their ship operations. Det Norske Veritas, the Norwegian classification society, has approved Teekay Corporation's safety management system as complying with the International Safety Management Code (or *ISM Code*), the International Standards Organization's (or *ISO*) 9001 for Quality Assurance, ISO 14001 for Environment Management Systems, and Occupational Health and Safety Advisory Services (or *OHSAS*) 18001, and this system has been implemented on all our ships. Australia's flag administration has approved this safety management system for our Australian-flagged vessel. As part of Teekay Corporation's *ISM Code* compliance, all the vessels' safety management certificates are being maintained through ongoing internal audits performed by Teekay Corporation's certified internal auditors and intermediate external audits performed by Det Norske Veritas and Australia's flag administration. Subject to satisfactory completion of these internal and external audits, certification is valid for five years.

Teekay Corporation provides, through certain of its subsidiaries, expertise in various functions critical to the operations of our operating subsidiaries. We believe this arrangement affords a safe, efficient and cost-effective operation. Teekay subsidiaries also provide to us access to human resources, financial and other administrative functions pursuant to administrative services agreements.

Critical ship management functions that certain subsidiaries of Teekay Corporation provide to our operating subsidiaries through the Teekay Marine Services division located in various offices around the world include:

- vessel maintenance;
- crewing;
- purchasing;
- shipyard supervision;
- insurance; and
- financial management services.

These functions are supported by onboard and onshore systems for maintenance, inventory, purchasing and budget management.

In addition, Teekay Corporation's day-to-day focus on cost control is applied to our operations. In 2003, Teekay Corporation and two other shipping companies established a purchasing alliance, Teekay Bergesen Worldwide, which leverages the purchasing power of the combined fleets, mainly in such commodity areas as lube oils, paints and other chemicals. Through our arrangements with Teekay Corporation, we benefit from this purchasing alliance.

We believe that the generally uniform design of some of our existing and newbuilding vessels and the adoption of common equipment standards provides operational efficiencies, including with respect to crew training and vessel management, equipment operation and repair, and spare parts ordering.

Risk of Loss, Insurance and Risk Management

The operation of any ocean-going vessel carries an inherent risk of catastrophic marine disasters, death or injury of persons and property losses caused by adverse weather conditions, mechanical failures, human error, war, terrorism, piracy and other circumstances or events. The occurrence of any of these events may result in loss of revenues or increased costs.

We carry hull and machinery (marine and war risks) and protection and indemnity insurance coverage to protect against most of the accident-related risks involved in the conduct of our business. Hull and machinery insurance covers loss of or damage to a vessel due to marine perils such as collisions, grounding and weather. Protection and indemnity insurance indemnifies against other liabilities incurred while operating vessels, including injury to the crew, third parties, cargo loss and pollution. The current available amount of our coverage for pollution is \$1 billion per vessel per incident. We also carry insurance policies covering war risks (including piracy and terrorism).

Under bareboat charters, the customer is responsible to insure the vessel. We believe that current insurance coverage is adequate to protect against most of the accident-related risks involved in the conduct of our business and that we maintain appropriate levels of environmental damage and pollution coverage. However, we cannot assure that all covered risks are adequately insured against, that any particular claim will be paid or that we will be able to procure adequate insurance coverage at commercially reasonable rates in the future. More stringent environmental regulations at times in the past have resulted in increased costs for, and may result in the lack of availability of, insurance against the risks of environmental damage or pollution. Substantially all of our vessels are not insured against loss of revenues resulting from vessel off-hire time, based on the cost of this insurance compared to our off-hire experience.

We use in our operations Teekay Corporation's thorough risk management program that includes, among other things, computer-aided risk analysis tools, maintenance and assessment programs, a seafarers competence training program, seafarers workshops and membership in emergency response organizations.

Classification, Audits and Inspections

All of our shuttle tankers and conventional oil tankers have been "classed" by one of the major classification societies: Det Norske Veritas, Lloyd's Register of Shipping or the American Bureau of Shipping. Although FSO and FPSO units are not required to be "classed", each of our FSO units has been inspected and certified as such. The classification society certifies that the vessel has been built and maintained in accordance with its rules and complies with applicable rules and regulations of the country of registry, although for some vessels this latter certification is obtained directly from the relevant flag state authorities. Each vessel is inspected by a classification society surveyor annually, with either the second or third annual inspection being a more detailed survey (an *Intermediate Survey*) and the fifth annual inspection being the most comprehensive survey (a *Special Survey*). The inspection cycle resumes after each Special Survey. Vessels may be required to be drydocked at each Intermediate and Special Survey for inspection of the underwater area and fittings. However, many of our vessels have qualified with their respective classification societies for drydocking every five years and are no longer subject to the Intermediate Survey drydocking process. To qualify, the resiliency of the underwater coatings of each vessel was enhanced and the hull was marked to accommodate underwater inspections by divers.

In addition to classification inspections:

- the vessel's flag state, or the vessel's classification society if nominated by the flag state, inspect the vessels to ensure they comply with applicable rules and regulations of the country of registry of the vessel and the international conventions of which that country is a signatory;
- port state control authorities, such as the U.S. Coast Guard and Australian Maritime Safety Authority, inspect vessels at regular intervals; and
- customers regularly inspect our vessels as a condition to chartering, and regular inspections are standard practice under long-term charters.

In addition to third-party audits and inspections, our seafarers regularly inspect their vessels and perform much of the necessary routine maintenance. Shore-based operational and technical specialists also inspect the vessels at least twice a year for conformity with established criteria. Upon completion of each inspection, recommendations are made for improving the overall condition of the vessel and its maintenance, safety and crew welfare. All recommendations are monitored until they are completed. The objective of these inspections are to:

- ensure adherence to our operating standards;
- maintain the structural integrity of the vessel is being maintained;
- maintain machinery and equipment to give full reliability in service;
- optimize performance in terms of speed and fuel consumption; and
- ensure the vessel's appearance will support our brand and meet customer expectations.

To achieve the vessel structural integrity objective, we use a comprehensive “Structural Integrity Management System” developed by Teekay Corporation. This system is designed to monitor the condition of the vessels closely and to ensure that structural strength and integrity are maintained throughout a vessel’s life.

Teekay Corporation, which assists us in managing our ship operations through its subsidiaries, has obtained approval for its safety management system as being in compliance with the ISM Code. Our safety management system has also been certified as being compliant with ISO 9001, ISO 14001 and OSHAS 18001 standards. To maintain compliance, the system is audited regularly by either the vessels’ flag state or, when nominated by the flag state, a classification society. Certification is valid for five years subject to satisfactorily completing internal and external audits.

Regulations

General

Our business and the operation of our vessels are significantly affected by international conventions and national, state and local laws and regulations in the jurisdictions in which our vessels operate, as well as in the country or countries of their registration. Because these conventions, laws and regulations change frequently, we cannot predict the ultimate cost of compliance or their impact on the resale price or useful life of the vessels. Additional conventions, laws and regulations may be adopted that could limit our ability to do business or increase the cost of doing business and that may materially adversely affect operations. We are required by various governmental and quasi-governmental agencies to obtain permits, licenses and certificates with respect to our operations. Subject to the discussion below and to the fact that the kinds of permits, licenses and certificates required for the operations of the vessels we own will depend on a number of factors, we believe that we will be able to continue to obtain all permits, licenses and certificates material to the conduct of operations.

We believe that the heightened environmental and quality concerns of insurance underwriters, regulators and charterers will generally lead to greater inspection and safety requirements on all vessels in the oil tanker markets and will accelerate the scrapping of older vessels throughout these markets.

Regulation — International Maritime Organization (or IMO)

The IMO is the United Nation’s agency for maritime safety. IMO regulations include the International Convention for Safety of Life at Sea (or SOLAS), including amendments to SOLAS implementing the International Security Code for Ports and Ships (or ISPS), the ISM Code, the International Convention on Prevention of Pollution from Ships (or the MARPOL Convention), the International Convention on Civil Liability for Oil Pollution Damage of 1969, the International Convention on Load Lines of 1966. The IMO Marine Safety Committee has also published guidelines for vessels with dynamic positioning (DP) systems, which would apply to shuttle tankers and DP-assisted FSO units and FPSO units. SOLAS provides rules for the construction of and equipment required for commercial vessels and includes regulations for safe operation. Flag states which have ratified the convention and the treaty generally employ the classification societies, which have incorporated SOLAS requirements into their class rules, to undertake surveys to confirm compliance.

SOLAS and other IMO regulations concerning safety, including those relating to treaties on training of shipboard personnel, lifesaving appliances, radio equipment and the global maritime distress and safety system, are applicable to our operations. Non-compliance with IMO regulations, including SOLAS, the ISM Code, ISPS and the specific requirements for shuttle tankers, FSO units and FPSO units under the NPD (Norway) and HSE (United Kingdom) regulations, may subject us to increased liability or penalties, may lead to decreases in available insurance coverage for affected vessels and may result in the denial of access to or detention in some ports. For example, the Coast Guard and European Union authorities have indicated that vessels not in compliance with the ISM Code will be prohibited from trading in U.S. and European Union ports.

The ISM Code requires vessel operators to obtain a safety management certification for each vessel they manage, evidencing the shipowner’s compliance with requirements of the ISM Code relating to the development and maintenance of an extensive “Safety Management System.” Such a system includes, among other things, the adoption of a safety and environmental protection policy setting forth instructions and procedures for safe operation and describing procedures for dealing with emergencies. Each of the existing vessels in our fleet currently is ISM Code-certified, and we expect to obtain safety management certificates for each newbuilding upon delivery.

Under IMO regulations an oil tanker must be of double-hull construction, be of a mid-deck design with double-side construction or be of another approved design ensuring the same level of protection against oil pollution in the event that such tanker:

- is the subject of a contract for a major conversion or original construction on or after July 6, 1993;
- commences a major conversion or has its keel laid on or after January 6, 1994; or
- completes a major conversion or is a newbuilding delivered on or after July 6, 1996.

In December 2003, the IMO revised its regulations relating to the prevention of pollution from oil tankers. These regulations, which became effective April 5, 2005, accelerated the existing mandatory phase-out of single-hull tankers and impose a more rigorous inspection regime for older tankers. All of our shuttle and conventional oil tankers are double-hulled and were delivered after July 6, 1996, so those tankers will not be affected directly by these IMO regulations.

Shuttle Tanker, FSO Unit and FPSO Unit Regulation

Our shuttle tankers primarily operate in the North Sea. In addition to the regulations imposed by the IMO, countries having jurisdiction over North Sea areas impose regulatory requirements in connection with operations in those areas, including HSE in the United Kingdom and NPD in Norway. These regulatory requirements, together with additional requirements imposed by operators in North Sea oil fields, require that we make further expenditures for sophisticated equipment, reporting and redundancy systems on the shuttle tankers and for the training of seagoing staff. Additional regulations and requirements may be adopted or imposed that could limit our ability to do business or further increase the cost of doing business in the North Sea. In Brazil, Petrobras serves in a regulatory capacity and has adopted standards similar to those in the North Sea.

Environmental Regulations — The United States Regulations

The United States has enacted an extensive regulatory and liability regime for the protection and cleanup of the environment from oil spills, including discharges of oil cargoes, bunker fuels or lubricants, primarily through the Oil Pollution Act of 1990 (or *OPA 90*) and the Comprehensive Environmental Response, Compensation and Liability Act (or *CERCLA*). OPA 90 affects all owners, bareboat charterers and operators whose vessels trade to the United States or its territories or possessions or whose vessels operate in United States waters, which include the U.S. territorial sea and 200-mile exclusive economic zone around the United States.

Under OPA 90, vessel owners, operators and bareboat charterers are “responsible parties” and are jointly, severally and strictly liable (unless the spill results solely from the act or omission of a third party, an act of God or an act of war and the responsible party reports the incident and reasonably cooperates with the appropriate authorities) for all containment and clean-up costs and other damages arising from discharges or threatened discharges of oil from their vessels. These other damages are defined broadly to include:

- natural resources damages and the related assessment costs;
- real and personal property damages;
- net loss of taxes, royalties, rents, fees and other lost revenues;
- lost profits or impairment of earning capacity due to property or natural resources damage;
- net cost of public services necessitated by a spill response, such as protection from fire, safety or health hazards; and
- loss of subsistence use of natural resources.

OPA 90 limits the liability of responsible parties. Effective as of October 9, 2006, the limit for double-hulled tank vessels was increased to the greater of \$1,900 per gross ton or \$16 million per double-hulled tanker per incident, subject to adjustment for inflation. These limits of liability would not apply if the incident were proximately caused by violation of applicable U.S. federal safety, construction or operating regulations, including IMO conventions to which the United States is a signatory, or by the responsible party’s gross negligence or willful misconduct, or if the responsible party fails or refuses to report the incident or to cooperate and assist in connection with the oil removal activities. In addition, CERCLA, which applies to the discharge of hazardous substances (other than oil) whether on land or at sea, contains a similar liability regime and provides for cleanup, removal and natural resource damages. Liability under CERCLA is limited to the greater of \$300 per gross ton or \$5 million, unless the incident is caused by gross negligence, willful misconduct, or a violation of certain regulations, in which case liability is unlimited. We currently maintain pollution liability coverage for each vessel, in the maximum coverage amount of \$1 billion per incident. A catastrophic spill could exceed the coverage available, which could harm our business, financial condition and results of operations.

Under OPA 90, with limited exceptions, all newly built or converted tankers delivered after January 1, 1994 and operating in U.S. waters must be built with double-hulls. All of our existing tankers are, and all of our newbuildings will be, double-hulled.

The U.S. Coast Guard (or *Coast Guard*) has implemented regulations requiring evidence of financial responsibility in an amount equal to the applicable OPA limitation on liability currently at \$1,900 per gross ton for a double hulled tanker, plus the CERCLA liability limit of \$300 per gross ton. Under the regulations, such evidence of financial responsibility may be demonstrated by insurance, surety bond, self-insurance, guaranty or an alternate method subject to agency approval. Under OPA 90, an owner or operator of a fleet of vessels is required only to demonstrate evidence of financial responsibility in an amount sufficient to cover the tanker in the fleet having the greatest maximum limited liability under OPA 90 and CERCLA.

The Coast Guard’s regulations concerning certificates of financial responsibility (or *COFR*) provide, in accordance with OPA 90, that claimants may bring suit directly against an insurer or guarantor that furnishes COFR. In addition, in the event that such insurer or guarantor is sued directly, it is prohibited from asserting any contractual defense that it may have had against the responsible party and is limited to asserting those defenses available to the responsible party and the defense that the incident was caused by the willful misconduct of the responsible party. Certain organizations, which had typically provided COFR under pre-OPA 90 laws, including the major protection and indemnity organizations have declined to furnish evidence of insurance for vessel owners and operators if they are subject to direct actions or required to waive insurance policy defenses.

The Coast Guard’s financial responsibility regulations may also be satisfied by evidence of surety bond, guaranty or by self-insurance. Under the self-insurance provisions, the ship-owner or operator must have a net worth and working capital, measured in assets located in the United States against liabilities located anywhere in the world, that exceeds the applicable amount of financial responsibility. We have complied with the Coast Guard regulations by obtaining financial guarantees from third-parties. If other vessels in our fleet trade into the United States in the future, we expect to obtain additional guarantees from third-party insurers or to provide guarantees through self-insurance.

OPA 90 and CERCLA permit individual states to impose their own liability regimes with regard to oil or hazardous substance pollution incidents occurring within their boundaries if the state’s regulations are equally or more stringent, and some states have enacted legislation providing for unlimited strict liability for spills. Several coastal states, including California, Washington and Alaska, require state specific COFR and vessel response plans. We intend to comply with all applicable state regulations in the ports where our vessels call.

Owners or operators of tank vessels operating in United States waters are required to file vessel response plans with the Coast Guard, and their tank vessels are required to operate in compliance with their Coast Guard approved plans. Such response plans must, among other things:

- address a “worst case” scenario and identify and ensure, through contract or other approved means, the availability of necessary private response resources to respond to a “worst case discharge”;
- describe crew training and drills; and
- identify a qualified individual with full authority to implement removal actions.

We have filed vessel response plans with the Coast Guard for the vessels we own and have received approval of such plans for all vessels in our fleet to operate in United States waters. In addition, we conduct regular oil spill response drills in accordance with the guidelines set out in OPA 90. The Coast Guard has announced it intends to propose similar regulations requiring certain vessels to prepare response plans for the release of hazardous substances.

Environmental Regulation — Other Environmental Initiatives

Although the United States is not a party, many countries have ratified and follow the liability scheme adopted by the IMO and set out in the International Convention on Civil Liability for Oil Pollution Damage, 1969, as amended (or *CLC*), and the Convention for the Establishment of an International Fund for Oil Pollution of 1971, as amended. Under these conventions, which are applicable to vessels that carry persistent oil as cargo, a vessel's registered owner is strictly liable for pollution damage caused in the territorial waters of a contracting state by discharge of persistent oil, subject to certain complete defenses. Many of the countries that have ratified the CLC have increased the liability limits through a 1992 Protocol to the CLC. The liability limits in the countries that have ratified this Protocol are currently approximately \$6.9 million plus approximately \$977 per gross registered tonne above 5,000 gross tonnes with an approximate maximum of \$139 million per vessel and the exact amount tied to a unit of account which varies according to a basket of currencies. The right to limit liability is forfeited under the CLC when the spill is caused by the owner's actual fault or privity and, under the 1992 Protocol, when the spill is caused by the owner's intentional or reckless conduct. Vessels trading to contracting states must provide evidence of insurance covering the limited liability of the owner. In jurisdictions where the CLC has not been adopted, various legislative schemes or common law govern, and liability is imposed either on the basis of fault or in a manner similar to the CLC.

In September 1997, the IMO adopted Annex VI to the International Convention for the Prevention of Pollution from Ships (or *Annex VI*) to address air pollution from ships. Annex VI, which became effective in May 2005, sets limits on sulfur oxide and nitrogen oxide emissions from ship exhausts and prohibit deliberate emissions of ozone depleting substances, such as halons, chlorofluorocarbons, emissions of volatile compounds from cargo tanks and prohibition of shipboard incineration of specific substances. Annex VI also includes a global cap on the sulfur content of fuel oil and allows for special areas to be established with more stringent controls on sulfur emissions. We plan to operate our vessels in compliance with Annex VI. Additional or new conventions, laws and regulations may be adopted that could adversely affect our ability to manage our ships.

In addition, the IMO, various countries and states, such as Australia, the United States and the State of California, and various regulators, such as port authorities, the U.S. Coast Guard and the EPA, have either adopted legislation or regulations, or are separately considering the adoption of legislation or regulations, aimed at regulating the discharge of ballast water and the discharge of bunkers as potential pollutants, and requiring the installation on ocean-going vessels of pollution prevention equipment such as oily water separators and bilge alarms.

The United States Clean Water Act prohibits the discharge of oil or hazardous substances in U.S. navigable waters and imposes strict liability in the form of penalties for unauthorized discharges. The Clean Water Act also imposes substantial liability for the costs of removal, remediation and damages and complements the remedies available under OPA 90 and CERCLA discussed above. Pursuant to regulations promulgated by the EPA in the early 1970s, the discharge of sewage and effluent from properly functioning marine engines was exempted from the permit requirements of the National Pollution Discharge Elimination System. This exemption allowed vessels in U.S. ports to discharge certain substances, including ballast water, without obtaining a permit to do so. However, on March 30, 2005, a U.S. District Court for the Northern District of California granted summary judgment to certain environmental groups and U.S. states that had challenged the EPA regulations, arguing that the EPA exceeded its authority in promulgating them. On September 18, 2006, the U.S. District Court in that action issued an order invalidating the exemption in EPA's regulations for all discharges incidental to the normal operation of a vessel as of September 30, 2008, and directing EPA to develop a system for regulating all discharges from vessels by that date.

The EPA appealed this decision to the Ninth Circuit Court of Appeals, which on July 23, 2008, upheld the District Court's decision. In response, the EPA adopted a new Clean Water Act permit titled the "Vessel General Permit." Effective February 6, 2009, container vessels (including all vessels of the type operated by us) operating as a means of transportation that discharge ballast water or certain other incidental discharges into U.S. waters must obtain coverage under the Vessel General Permit and comply with a range of best management practices, reporting, inspections and other requirements. The Vessel General Permit also incorporates U.S. Coast Guard requirements for ballast water management and exchange and includes specific technology-based requirements for vessels, including oil and petroleum tankers. Under certain circumstances, the EPA may also require a discharger of ballast water or other incidental discharges to obtain an individual permit in lieu of coverage under the Vessel General Permit. These new requirements will increase the cost of operating our vessels in U.S. waters.

Since the EPA's adoption of the Vessel General Permit, several U.S. states have added specific requirements to the permit through the Clean Water Act section 401 certification process (which varies from state to state) and, in some cases, require vessels to install ballast water treatment technology to meet biological performance standards.

Since January 2009, several environmental groups and industry associations have filed challenges in U.S. federal court to the EPA's issuance of the Vessel General Permit. These cases are still in early procedural stages of litigation.

In Norway, the Norwegian Pollution Control Authority requires the installation of volatile organic compound emissions (or *VOC equipment*) on most shuttle tankers serving the Norwegian continental shelf. Oil companies bear the cost to install and operate the VOC equipment onboard the shuttle tankers.

Vessel Security Regulation

The ISPS was adopted by the IMO in December 2002 in the wake of heightened concern over worldwide terrorism and became effective on July 1, 2004. The objective of ISPS is to enhance maritime security by detecting security threats to ships and ports and by requiring the development of security plans and other measures designed to prevent such threats. The United States implemented ISPS with the adoption of the Maritime Transportation Security Act of 2002 (or *MTSA*), which requires vessels entering U.S. waters to obtain certification of plans to respond to emergency incidents there, including identification of persons authorized to implement the plans. Each of the existing vessels in our fleet currently complies with the requirements of ISPS and MTSA.

C. Organizational Structure

Our sole general partner is Teekay Offshore GP L.L.C., which is a wholly owned subsidiary of Teekay Corporation. Teekay Corporation also controls its public subsidiaries Teekay LNG Partners L.P. (NYSE: TGP) and Teekay Tankers Ltd. (NYSE: TNK).

Please read Exhibit 8.1 to this Annual Report for a list of our significant subsidiaries as of December 31, 2008.

D. Properties

Other than our vessels and VOC plants mentioned above, we do not have any material property.

E. Taxation of the Partnership

United States Taxation

This discussion is based upon provisions of the U.S. Internal Revenue Code of 1986, as amended (or the *Code*) as in effect on the date of this Annual Report, existing final and temporary regulations thereunder (or *Treasury Regulations*), and current administrative rulings and court decisions, as in effect on the date of this Annual Report, all of which are subject to change, possibly with retroactive effect. Changes in these authorities may cause the tax consequences to vary substantially from the consequences described below. The following discussion is for general information purposes only and does not purport to be a comprehensive description of all of the U.S. federal income tax considerations applicable to us.

Election to be Taxed as a Corporation. We have elected to be taxed as a corporation for U.S. federal income tax purposes. As such, we are subject to U.S. federal income tax on our income to the extent it is from U.S. sources or otherwise is effectively connected with the conduct of a trade or business in the United States as discussed below.

Taxation of Operating Income. We expect that substantially all of our gross income will be attributable to the transportation of crude oil and related products. For this purpose, gross income attributable to transportation (or *Transportation Income*) includes income derived from, or in connection with, the use (or hiring or leasing for use) of a vessel to transport cargo, or the performance of services directly related to the use of any vessel to transport cargo, and thus includes both time charter or bareboat charter income.

Transportation Income that is attributable to transportation that begins or ends, but that does not both begin and end, in the United States (or *U.S. Source International Transportation Income*) will be considered to be 50.0% derived from sources within the United States. Transportation Income attributable to transportation that both begins and ends in the United States (or *U.S. Source Domestic Transportation Income*) will be considered to be 100.0% derived from sources within the United States. Transportation Income attributable to transportation exclusively between non-U.S. destinations will be considered to be 100% derived from sources outside the United States. Transportation Income derived from sources outside the United States generally will not be subject to U.S. federal income tax.

Based on our current operations, we expect substantially all of our Transportation Income to be from sources outside the United States and not subject to U.S. federal income tax. However, certain of our activities could give rise to U.S. Source International Transportation Income, and future expansion of our operations could result in an increase in the amount of U.S. Source International Transportation Income, as well as give rise to U.S. Source Domestic Transportation Income, all of which could be subject to U.S. federal income taxation, unless the exemption from U.S. taxation under Section 883 of the Code (or the *Section 883 Exemption*) applies.

The Section 883 Exemption. In general, the Section 883 Exemption provides that if a non-U.S. corporation satisfies the requirements of Section 883 of the Code and the Treasury Regulations thereunder (or the *Section 883 Regulations*), it will not be subject to the net basis and branch taxes or 4.0% gross basis tax described below on its U.S. Source International Transportation Income. The Section 883 Exemption only applies to U.S. Source International Transportation Income. As discussed below, we believe that under our current ownership structure, the Section 883 Exemption will apply and we will not be taxed on our U.S. Source International Transportation Income. The Section 883 Exemption does not apply to U.S. Source Domestic Transportation Income.

A non-U.S. corporation will qualify for the Section 883 Exemption if it is organized in a jurisdiction outside the United States that grants an equivalent exemption from tax to corporations organized in the United States (or an *Equivalent Exemption*), it meets one of three ownership tests (or the *Ownership Test*) described in the Final Section 883 Regulations and it meets certain substantiation, reporting and other requirements.

We are organized under the laws of the Republic of the Marshall Islands. The U.S. Treasury Department has recognized the Republic of the Marshall Islands as a jurisdiction that grants an Equivalent Exemption. Consequently, our U.S. Source International Transportation Income (including for this purpose, any such income earned by our subsidiaries that have properly elected to be treated as partnerships or disregarded as entities separate from us for U.S. federal income tax purposes) will be exempt from U.S. federal income taxation provided we meet the Ownership Test described in the Final Section 883 Regulations. As a result of an offering of our common units in 2008, Teekay Corporation indirectly owns less than 50.0% of our outstanding units and, depending upon the valuation of the general partner interest Teekay Corporation indirectly owns in us, may own 50.0% or less of the value of us. In the event Teekay Corporation does not indirectly own more than 50.0% of the value of our outstanding equity interests for more than half of the days in a given year, we generally will not satisfy the Ownership Test and therefore would not satisfy the requirements of the Section 883 Exemption. In that event, our U.S. Source International Transportation Income would not be exempt from U.S. federal income taxation by reason of Section 883. We believe that we should satisfy the Ownership Test based upon the ownership of more than 50% of the value of us by Teekay Corporation. However, the determination of whether we satisfy the Ownership Test at any given time depends upon a multitude of factors, including Teekay Corporation's ownership of us, whether Teekay Corporation's stock is publicly traded, the concentration of ownership of Teekay Corporation's own stock and the satisfaction of various substantiation and documentation requirements. There can be no assurance that we will satisfy these requirements at any given time and thus that our U.S. Source International Shipping Income would be exempt from U.S. federal income taxation by reason of Section 883 in any of our taxable years.

The Net Basis Tax and Branch Profits Tax. If we earn U.S. Source International Transportation Income and the Section 883 Exemption does not apply, such income may be treated as effectively connected with the conduct of a trade or business in the United States (or *Effectively Connected Income*) if we have a fixed place of business in the United States and substantially all of our U.S. Source International Transportation Income is attributable to regularly scheduled transportation or, in the case of bareboat charter income, is attributable to a fixed place of business in the United

States. Based on our current operations, none of our potential U.S. Source International Transportation Income is attributable to regularly scheduled transportation or is received pursuant to bareboat charters attributable to a fixed place of business in the United States. As a result, we do not anticipate that any of our U.S. Source International Transportation Income will be treated as Effectively Connected Income. However, there is no assurance that we will not earn income pursuant to regularly scheduled transportation or bareboat charters attributable to a fixed place of business in the United States in the future, which would result in such income being treated as Effectively Connected Income.

U.S. Source Domestic Transportation Income generally is treated as Effectively Connected Income.

Any income we earn that is treated as Effectively Connected Income would be subject to U.S. federal corporate income tax (the highest statutory rate is currently 35.0%). In addition, if we earn income that is treated as Effectively Connected Income, a 30.0% branch profits tax imposed under Section 884 of the Code generally would apply to such income, and a branch interest tax could be imposed on certain interest paid or deemed paid by us.

On the sale of a vessel that has produced Effectively Connected Income, we could be subject to the net basis corporate income tax and to the 30.0% branch profits tax with respect to our gain not in excess of certain prior deductions for depreciation that reduced Effectively Connected Income. Otherwise, we would not be subject to U.S. federal income tax with respect to gain realized on the sale of a vessel, provided the sale is considered to occur outside of the United States under U.S. federal income tax principles.

The 4.0% Gross Basis Tax. If the Section 883 Exemption does not apply and the net basis tax does not apply, we would be subject to a 4.0% U.S. federal income tax on the U.S. source portion of our gross U.S. Source International Transportation Income, without benefit of deductions.

Marshall Islands Taxation

Because we and our controlled affiliates do not, and we do not expect that we and our controlled affiliates will, conduct business or operations in the Republic of The Marshall Islands, neither we nor our controlled affiliates are subject to income, capital gains, profits or other taxation under current Marshall Islands law. As a result, distributions by OPCO or other controlled affiliates to us are not subject to Marshall Islands taxation.

Norway Taxation

The following discussion is based upon the current tax laws of the Kingdom of Norway and regulations, the Norwegian tax administrative practice and judicial decisions thereunder, all as in effect as of the date of this Annual Report and subject to possible change on a retroactive basis. The following discussion is for general information purposes only and does not purport to be a comprehensive description of all of the Norwegian income tax considerations applicable to us.

Our Norwegian subsidiaries are subject to taxation in Norway on their income regardless of where the income is derived. The generally applicable Norwegian income tax rate is 28%.

Taxation of Norwegian Subsidiaries Engaged in Business Activities. All of our Norwegian subsidiaries (limited liability companies) are subject to regular Norwegian taxation on their world wide income. The generally applicable Norwegian income tax rate is 28%. Generally, a Norwegian resident company is taxed on its income realized for tax purposes. The starting point for calculating taxable income is the company's income as shown on its annual accounts, calculated under generally accepted accounting principles and as adjusted for tax purposes. Gross income will include capital gains, interest, dividends from certain corporations and foreign exchange gains.

The Norwegian companies also are taxed on any gains resulting from the sale of assets. The gain on depreciable assets is taken into income for Norwegian tax purposes at a rate of 20.0% per year on a declining balance basis.

Norway does not allow consolidation of the income of companies in a corporate group for Norwegian tax purposes. However, a group of companies that is ultimately owned more than 90.0% by a single company can transfer its Norwegian taxable income to another Norwegian resident company in the group by making a transfer to the other company (this is referred to as making a "group contribution"). The ultimate parent in the corporate group can be a foreign company.

Group contributions are deductible for the contributing company for tax purposes and are included in the taxable income of the receiving company in the income year in which the contribution is made. Group contributions are subject to the same rules as dividend distributions under the Norwegian Companies Act. In other words, group contributions are restricted to the amount that is available to distribute as dividends for corporate law purposes.

Taxation of Controlled Foreign Corporations. Norwegian companies are also taxable on certain income earned by controlled foreign corporations (or CFCs) resident in low tax countries. A CFC for these purposes is a foreign resident company in which 50.0% or more of the shares or capital is owned or controlled by Norwegian resident companies or individuals, such as Navion Offshore Loading AS's Singapore subsidiary, Teekay Navion Offshore Loading Pte. (or TNOL). A country is a low tax country if the CFC's income tax on profits is less than two-thirds of the Norwegian tax that would apply if the company were resident in Norway. Income earned by a CFC is directly included in the taxable income of its Norwegian parent. Norwegian CFC taxation is not imposed if the foreign company is resident in a low tax country with which Norway has concluded a tax treaty, unless the income that the foreign company earns is mainly of a passive nature. Also, Norwegian CFC taxation is not imposed if the foreign company is resident in a country within the European Economic Area, and it is proved that the foreign company is genuinely established and performs genuine business activities in the relevant country within the European Economic Area.

Taxation of Foreign Companies and Permanent Establishments. Foreign registered companies are subject to Norwegian world wide taxation if the company's place of effective management is situated in Norway (Norwegian resident companies). Furthermore, foreign resident companies are taxable in Norway on business activities performed through a permanent establishment in Norway. Foreign resident companies engaged in activities related to the exploration or exploitation of subsoil petroleum on the Norwegian continental shelf are taxable in Norway under domestic law according to the Norwegian Petroleum Tax Act. The same applies to foreign companies participating in partnerships engaged in activities on the Norwegian continental shelf.

Taxation of Dividends. Generally, only 3% of dividends received by a Norwegian resident company are taxable under the Norwegian participation exemption (at the standard tax rate of 28%). The participation exemption rule does not apply to dividends from companies resident outside the

European Economic Area if (a) the country of residence is a low-tax country or (b) the ownership of shares in the distributing company is considered to be a “portfolio investment” (i.e. less than 10.0% share ownership or less than two years continuous ownership period). Nor does the participation exemption rule apply to dividends from companies' resident within the European Economic Area if (a) the country of residence is a low-tax country and (b) the company is not genuinely established or does not perform genuine business activities in the relevant country within the European Economic Area. Dividends that do not qualify under the participation exemption rule are subject to the general 28% income tax rate when received by the Norwegian resident company, unless an applicable tax treaty provides for a reduced tax rate or an exemption.

Correction Income Tax. Our Norwegian subsidiaries may be subject to a tax, called *correction income tax*, on their dividend distributions. Norwegian correction tax is levied if a dividend distribution leads to the company's balance sheet equity at year end being lower than the company's paid-in share capital (including share premium), plus a calculated amount equal to 72.0% of the net positive temporary timing differences between the company's book values and tax values.

As a result, correction tax is effectively levied if dividend distributions result in the company's financial statement equity for accounting purposes being reduced below its equity calculated for tax purposes (i.e. when dividends are paid out of accounting earnings that have not been subject to taxation in Norway). In addition to dividend distributions, correction tax may also be levied on the partial liquidation of the share capital of the company or if the company makes group contributions that are in excess of taxable income for the year.

Taxation of Interest Paid by Norwegian Entities. Norway does not levy any tax or withholding tax on interest paid by a Norwegian resident company to a company that is not resident in Norway (provided that the interest rate and the debt/equity ratio are based on arms-length principles). Therefore, any interest paid by our Norwegian subsidiaries to companies that are not resident in Norway will not be subject to Norwegian withholding tax.

Taxation on Distributions by Norwegian Entities. Norway levies a 25.0% withholding tax on non-residents of Norway that receive dividends from a Norwegian resident company. However, the Norwegian withholding tax may be reduced if the recipient of the dividend is resident in a country that has an income tax treaty with Norway. If the recipient of the dividend is a company resident within the European Economic Area, and the recipient is genuinely established and performs genuine business activities in the relevant country, the dividend will be exempt from Norwegian withholding tax. We believe that distributions by our Norwegian subsidiaries will be subject to a reduced amount of Norwegian withholding tax or not be subject to Norwegian withholding tax.

We do not expect that payment of Norwegian income taxes will have a material effect on our results.

Luxembourg Taxation

The following discussion is based upon the current tax laws of Luxembourg and regulations, the Luxembourg tax administrative practice and judicial decisions thereunder, all as in effect as of the date of this Annual Report and subject to possible change on a retroactive basis. The following discussion is for general information purposes only and does not purport to be a comprehensive description of all of the Luxembourg income tax considerations applicable to us.

Our operating subsidiary, Teekay Offshore Operating L.P. owns all of the shares of Norsk Teekay Holdings Ltd. (or *Norsk Teekay*), a Marshall Islands company. Norsk Teekay owns all of the shares of Teekay European Holdings S.a.r.l. (or *TEHS*), a Luxembourg company. TEHS owns all of the shares of Teekay Netherlands European Holdings BV (or *Teekay Netherlands*), a Netherlands company.

TEHS was primarily capitalized with a discounted loan from Norsk Teekay (the proceeds of which TEHS used to purchase shares in Norsk Teekay AS, which were immediately then contributed to Teekay Netherlands), which we believe were compliant with the Luxembourg thin capitalization threshold and a fixed interest loan from OPCO. Its only significant assets are shares of Teekay Netherlands and a fixed interest loan to Navion Offshore Loading AS (or *NOL*).

TEHS is considered a Luxembourg resident company subject to taxation in Luxembourg on its income regardless of where the income is derived. The generally applicable Luxembourg income tax rate is 28.59%.

Taxation of Interest Income. TEHS' loans to NOL generate interest income. However, this interest income is substantially offset by interest expense on the loan made by OPCO to TEHS. Accordingly, at TEHS' current level of indebtedness and provided that TEHS does not bear any foreign exchange risk, TEHS should earn a minimum level of net interest income equal to 0.0625% of the loan balance to NOL, an immaterial amount that will be subject to taxation in Luxembourg. The net interest income generated from the loans to NOL can also, to the extent the interest due on the discounted loan from Norsk Teekay exceeds any dividend income from Teekay Netherlands during the same year be offset by interest expense on TEHS' discounted loan payable to Norsk Teekay. The deduction of interest expense on the discounted loan is subject to recapture in the future, as discussed below.

Taxation of Potential Foreign Currency Exchange Net Gain. TEHS holds its accounts in Euros, while the loan to NOL is denominated in Norwegian Kroner. Regardless whether they are realized or unrealized, foreign currency exchange gains are generally fully taxable in Luxembourg to the extent they are reflected in the accounts (under Luxembourg GAAP). Foreign currency exchange losses are in principle deductible from the taxable base of TEHS under the same conditions. We minimized such foreign exchange exposure by having the loan from OPCO also Norwegian Kroner denominated and with the exact same terms and conditions (same principal amount and same effective date and maturity save for a differential in the interest rates leading to the small net interest income noted above) as the loan to NOL. Accordingly, we believe that the foreign exchange net gain on the loan from OPCO and on the loan to NOL should be minimized in Luxembourg.

Taxation of Interest Payments. Luxembourg does not levy a withholding tax on interest paid to non-residents of Luxembourg, such as Norsk Teekay and OPCO, unless the Council Directive 2003/48/EC (or *European Savings Directive*) would apply, or the interest represents a right to participate in profits of the interest-paying entity and the debt has certain other characteristics or the interest payment relates to the portion of debt used to acquire share capital, and the debt exceeds a Luxembourg “thin capitalization” threshold, or the interest rate is not regarded to be at arm's length. We believe that the interest paid by TEHS on the types of loans made to it by Norsk Teekay and OPCO does not represent a right to participate in its profits and is consistent with Luxembourg transfer pricing rules. Furthermore, we have capitalized TEHS to meet the “thin capitalization” threshold. Accordingly, we believe that interest payments made by TEHS to Norsk Teekay and OPCO are not subject to Luxembourg withholding tax.

Taxation of Dividends and Capital Gains. Pursuant to Luxembourg law, dividends received by TEHS from Teekay Netherlands and capital gains realized on any disposal of shares of Teekay Netherlands generally are exempt from Luxembourg taxation if the following requirements are met:

- TEHS is a capital company resident in Luxembourg and fully subject to tax in this country;
- TEHS owns more than 10% of Teekay Netherlands, or alternatively, TEHS' acquisition price for the shares of Teekay Netherlands equals or exceeds Euro 1.2 million for purposes of the dividend exemption or Euro 6.0 million for purposes of the capital gains exemption;
- At the time of the dividend or disposal of shares, TEHS has owned the shares for at least 12 months (or, alternatively in the case of dividends, TEHS commits to hold the shares for at least 12 months and in the case of capital gains, TEHS commits to continue to hold at least 10% of the shares of Teekay Netherlands for at least 12 months); and
- Teekay Netherlands is a resident of the Netherlands for Dutch tax purposes and is covered by the European Union Parent-Subsidiary Directive.

TEHS meets the ownership threshold and has owned the shares in Teekay Netherlands for at least 12 months. In addition, assuming that Teekay Netherlands is a resident of the Netherlands for Dutch tax purposes and is fully subject to the Dutch general corporate tax regime (even if it has subsidiaries that may be subject to special shipping regimes), we believe that Teekay Netherlands is covered by the European Union Parent-Subsidiary Directive. Therefore, we believe that any dividend received on or any capital gain resulting from the disposition of the shares of Teekay Netherlands will be exempt from taxation in Luxembourg.

Notwithstanding this exemption, Luxembourg law does not permit the deduction of interest expense on loans used to purchase shares eligible for the dividend and capital gain exemption noted above, to the extent of the dividend received. Similarly, capital gains, although generally eligible for the exemption discussed above, are subject to Luxembourg taxation to the extent of any such related interest expense that has been deducted from TEHS' taxable income (such as the net interest income on loans to NOL), in the year of disposal and for any previous year the shares have been held.

We intend to operate TEHS such that it will not dispose of its shares in Teekay Netherlands. Accordingly, we believe that TEHS will not be subject to Luxembourg dividend or capital gains taxation, and, even if it were, it would only be affected to the extent of the recapture of interest deductions discussed above.

Taxation of TEHS Dividends. Luxembourg levies a 15% withholding tax on dividends paid by a Luxembourg company to a non-EU resident, absent an Income Tax Treaty, which would apply to dividends paid by TEHS to Norsk Teekay. However, we currently do not expect to cause TEHS to pay dividends, but to distribute all of its available cash through the payment of interest and principal on its loans owing to Norsk Teekay and/or OPCO. In addition, under current Luxembourg tax rules, it is possible to re-leverage the Luxembourg operations with new debt, which would allow a new Luxco to continue to distribute all of its available cash through payments of interest and principal on the new debt.

Net Wealth Tax. Luxembourg companies are also subject to a net wealth tax, which normally is based on the company's net asset value. Capital stock held by a company that qualifies for the dividend and capital gains exemption discussed above are excluded from net asset value in calculating this tax. Liabilities related to shareholdings excluded from the net wealth tax are not deductible from other assets subject to the net wealth tax. Furthermore, cash amounts held on January 1 with respect to the payments of interest or dividends to TEHS are subject to the net wealth tax. The cash balance on the last closed financial statements is generally used to determine the cash amount. Because the shares of Teekay Netherlands and the discounted loan from Norsk Teekay should be excluded from the net asset value according to the above, and taking into account that the loan to NOL should be offset by corresponding loan from OPCO, Luxco should be required to pay a nominal amount of Luxembourg net wealth tax.

Netherlands Taxation

The following discussion is based upon the current tax laws of the Kingdom of the Netherlands and regulations, the Dutch tax administrative practice and judicial decisions thereunder, all as in effect as of the date of this prospectus and subject to possible change on a retroactive basis. The following discussion is for general information purposes only and does not purport to be a comprehensive description of all of the Dutch corporate income tax considerations applicable to us.

Teekay Netherlands is capitalized solely with equity from TEHS, the Luxembourg shareholder. Its only significant asset is the shareholding in Norsk Teekay AS (or *NTAS*), which is an intermediate holding company and is the direct or indirect parent of various operating subsidiaries in Norway and Singapore, including Teekay Norway AS (or *TNAS*), Navion Offshore Loading AS (or *NOL*), Navion Gothenburg AS (or *NGAS*), Navion Bergen AS (or *NBAS*), Uglan Nordic Shipping AS (or *UNS*), PR Stena Uglan Shuttle Tanker I DA (or *Stena I*), PR Stena Uglan Shuttle Tankers II DA (or *Stena II*), and Teekay Navion Offshore Loading PTE. Ltd. (or *TNOL*).

Taxation of Dividends and Capital Gains. Pursuant to Dutch law, dividends received by Teekay Netherlands from NTAS and capital gains realized on any disposal of the shares of NTAS generally will be exempt from Dutch taxation (the participation exemption) if the following conditions are met:

- the company in which the shareholding is held, has a capital divided into shares;
- the shareholding is at least 5% of the paid up share capital of the company;
- the consolidated assets of the participation do not, directly or indirectly, consist for more than 50% out of portfolio investments ("asset test");
- in case that the participation's assets do, directly or indirectly, consist for more than 50% out of portfolio investments, the participation should be subject to a profit tax which results in taxation at a rate of at least 10% on a profit determined according to Dutch corporate income tax rules – the "subject to tax test".

Ownership test. NTAS' equity is wholly divided into shares. Teekay Netherlands meets the ownership threshold, and we currently expect that Teekay Netherlands will maintain its 100 % ownership interest in NTAS for the foreseeable future.

Asset test. Whether a shareholder's interest in a company is considered to be a "portfolio investment" is determined solely by the assets of that company (based on the fair market value of the assets). For example, if the 'consolidated' assets of that company are predominantly portfolio investments or consist predominantly (50% or more) of assets used for passive group finance activities (e.g. group loans), the shareholder's interest will in principle be considered a portfolio investment. Portfolio investments are assets that are not used in the line of the business of the company. Only assets will be consolidated. This means that mutual claims and debts of subsidiaries will not be eliminated. The assets will be taken into account for their fair market value. This also applies to assets that have not been commercially activated, such as the company's own goodwill and other intangible assets.

Subject to tax test. If the asset test is not met then the participation exemption should still apply to shareholdings of 5% or more in foreign (as well as domestic) entities, unless the shareholder's interest is a portfolio investment in a company that is not subject to a tax rate that is considered adequate. Adequate is defined as subject to a profit tax that equals at least an effective tax rate of 10% over a taxable base according to Dutch tax standards.

Conclusion. Because Teekay Netherlands' interest in NTAS should not be considered a low taxed portfolio investment by now and in the foreseeable future, dividends received on or any capital gain resulting from the disposition of the shares of NTAS should be exempt from taxation in the Netherlands. Capital losses on a disposition of the shares of NTAS should not be tax deductible.

Taxation of Teekay Netherlands Dividends. In general, the Netherlands levies a 15% withholding tax on dividends paid by a Dutch company. The withholding tax is reduced to zero if the dividend is paid by Teekay Netherlands to TEHS, if TEHS meets the conditions of the European Union Parent-Subsidiary Directive. The Directive requires TEHS to hold at least 5% of the shares of Teekay Netherlands for at least one year before the dividend distribution. Based on Dutch tax legislation no holding period is required. We currently expect that TEHS will maintain its 100% ownership interest in Teekay Netherlands for the foreseeable future. Therefore, we believe that no Dutch withholding tax will be due on dividends paid by Teekay Netherlands to TEHS. In addition, TEHS should not be liable to Dutch corporate income tax with regards to the dividends received.

Singapore Taxation

Taxation of Singapore Companies Operating Ships in International Traffic. OPCO has one subsidiary that is incorporated and tax resident in Singapore for Singapore tax purposes, Teekay Navion Offshore Loading Pte. Ltd. (or *TNOL*).

Taxation of Charter Income from Non-Singapore-Registered Ships. In respect of the charter income that TNOL earns from its non-Singapore-registered ships, they are currently exempt from Singapore tax under a tax incentive being enjoyed by TNOL. TNOL was conferred the Singapore Approved International Shipping (or *AIS*) status with effect from January 1, 2005. The AIS status was granted for an initial period of 10 years subject to a review at the end of the fifth year to ensure that TNOL has complied with the qualifying conditions of the incentive. At the end of the first 10 years, TNOL can apply for a further 10-year extension of the incentive.

Under Section 13F of the Singapore Income Tax Act and the terms of the AIS incentive approval letter from the Maritime Port Authority of Singapore (or *MPA*) dated January 2005, the types of income that would qualify for tax exemption include:

- charter hire/freight income from the operation of non-Singapore-registered vessels outside the limits of the port of Singapore;
- dividends from approved shipping subsidiaries;
- gains from the disposition of non-Singapore-registered ships for a period of 10 years from January 1, 2004 to December 31, 2013; and
- gains from foreign exchange and risk management activities which are carried out incurred in connection with the Singapore shipping operations.

The AIS status awarded to TNOL is subject to TNOL meeting and continuing to meet the following conditions:

- be a tax resident in Singapore;
- own and operate a significant fleet of ships;
- implement the business plan agreed with the MPA at the time of application of the incentive or such other modified plans as approved by the MPA;
- the company's shipping operations should be controlled and managed in Singapore;
- incur directly attributable business spending in Singapore an average of S\$4 million a year;
- support and make significant use of Singapore's trade infrastructure, such as banking, financial, business training, arbitration, and other ancillary services;
- all ships chartered-in must be conducted on an arm's-length basis;
- inform the MPA of any changes to its Group shareholdings and operations;
- keep proper books and records and submit annual audited accounts to the MPA, together with an annual audited statement comparing the actual total business spending in Singapore against the projected amount within 3 months of their completion; and

- disclose such information to and permit such inspection of its premises by the Singapore Government, as required.

TNOL intends to operate such that substantially all of its charter income will be exempt from Singapore tax under the AIS incentive. It also intends to operate and charter out all of its non-Singapore-registered ships in international waters outside the limits of the port of Singapore. On this basis, it expects that all of its income from the charter of its non-Singapore-registered ships should be exempt from Singapore tax under Section 13F of the Singapore Income Tax Act.

Taxation of Investment Income. Any investment income earned by TNOL would be subject to the normal corporate tax rules. With respect to the interest income earned from deposits placed outside Singapore, the interest will be taxable in Singapore at the prevailing corporate tax rate (currently 18.0%) when received or deemed received in Singapore.

There is a one year moratorium for foreign sourced investment income accrued up to 21 January 2009 to be exempted from tax even if they are remitted into Singapore between 22 January 2009 and 21 January 2010.

Taxation of Ship Management Income. In addition to the above, since October 2006 TNOL has provided ship management services to related and third party companies. Income from such activities does not qualify for exemption under the AIS incentive. Accordingly, the income derived from these activities is subject to tax at the prevailing corporate tax rate of 18.0%.

Australian Taxation

The following discussion is based upon the current tax laws of Australia and regulations, the Australian tax administrative practice and judicial decisions thereunder, all as in effect as of the date of this Annual Report and subject to possible change on a retroactive basis. The following discussion is for general information purposes only and does not purport to be a comprehensive description of all Australian income tax considerations applicable to us. This discussion only considers Australian income tax and does not cover any other taxes which may be relevant e.g. stamp duty, goods and services tax, customs and excise duty, etc.

Teekay Offshore Australia Trust (or the *Trust*), which owns and operates the *Karratha Spirit* vessel in Australian waters, is an Australian resident trust for Australian tax purposes. OPCO is the non-resident beneficiary of the Trust.

As a non-resident beneficiary of the Trust, OPCO is subject to Australian tax on the taxable income of the Trust derived from Australian sources. Since the Trust only operates one asset, the *Karratha Spirit*, it is expected that all taxable income of the Trust has an Australian source.

Since, however, OPCO is not a resident of Australia the trustee of the Trust is required to pay the Australian tax due, on behalf of OPCO (the non-resident beneficiary). This is at 30.0% of the taxable income of the Trust. An income tax return is required to be filed by the trustee of the Trust for the income year.

OPCO is required to file an Australian tax return disclosing the taxable income related to the Trust and receives a credit for the tax paid by the trustee. Hence, no further Australian income tax should be due by the Trust. Generally, the trustee of the Trust will be taxable on its income attributable to its operations in Australia calculated under generally accepted accounting principles, as adjusted for tax purposes. Gross income will include capital gains, interest and realized foreign exchange gains and losses from both Australian and foreign sources. Trusts are subject to capital gains on the disposition of different classes of assets, including those which are used to carry on a business in Australia, and land and buildings situated in Australia. Capital gains can be offset by any capital losses incurred in the current year, in addition to any carried forward capital losses. Net capital gains generated by a trust are taxed at the general corporate rate of 30.0%.

Generally, a Trust is allowed to deduct the expenses it incurs in a taxation year, to the extent the expenses are incurred to earn the Australian sourced income. The Australian operations of the Trust are partly financed by debt. As such, to the extent the interest expense is allocable to the Australian sourced income it should generate interest deductions, subject to thin capitalization restrictions.

Teekay Australia Offshore Holdings Pty Ltd. (or *TAOH*) was incorporated in August of 2007 and is owned directly by us. TAOH is the sole member of Dampier Spirit LLC, which owns and operates the *Dampier Spirit* vessel in Australian waters. Together, TAOH and Dampier Spirit LLC form a tax consolidated group for Australian tax reporting purposes. The consolidated group is taxed as a regular Australian company and is subject to Australian domestic tax law. The consolidated group is taxed on its consolidated taxable income at the Australian corporate tax rate of 30% and is required to file an Australian tax return.

Thin capitalization measures apply which limit the deductibility of interest expenditure incurred by non-residents carrying on a business in Australia. The measures apply to the total debt of the Australian operations of multinational groups such that interest deductions are denied to the extent that borrowings exceed a safe harbor ratio or, alternatively, an arm's length debt amount (as so calculated under the provisions of the Australian income tax legislation). Broadly, the safe harbor maximum amount of Australian debt for the Australian operations of a non-resident is 75.0% of the accounting book value of the assets of the Australian operations (except for deferred tax assets and liabilities, defined benefit plans but includes recognition and revaluation of certain internally generated intangible assets) after being reduced by non-debt liabilities (calculated on an average basis).

Teekay Navion Offshore Loading Pte Limited (or *TNOL*) is a non-resident entity which owns a vessel, the *Basker Spirit*, operating in Australian waters. Under a specific taxing provision, TNOL is deemed to have Australian taxable income equivalent to 5% of the gross payments received under the time-charter agreement with the customer. Tax arises at 30% on this deemed taxable income. This treatment has been confirmed by the Australian Taxation Office who has issued a ruling in this regard. Pursuant to the contractual terms of the time charter agreement this tax is for the charterer's (or customer's) account.

Taxation of Interest Paid To A Non-Resident. Australia levies withholding tax on interest paid to a non-resident where the interest relates to Australian operations. Therefore, any interest paid to non-residents will be subject to Australian withholding tax. Withholding tax is levied on payments of interest made to non residents, regardless of whether the interest deduction is allowed pursuant to other provisions of the Australian tax legislation. The withholding tax rate on interest is generally 10.0%, with the exception of certain interest payments to U.S. and U.K. resident financial institutions, whereby the rate is reduced to 0.0%.

Item 4A. Unresolved Staff Comments

Not applicable.

Item 5. Operating and Financial Review and Prospects

The following discussion should be read in conjunction with the financial statements and notes thereto appearing elsewhere in this report.

Management's Discussion and Analysis of Financial Condition and Results of Operations

OVERVIEW

We are an international provider of marine transportation and storage services to the offshore oil industry. We were formed in August 2006 by Teekay Corporation, a leading provider of marine services to the global oil and natural gas industries, to further develop its operations in the offshore market. Our principal asset is a 51% controlling interest in Teekay Offshore Operating L.P. (or *OPCO*), which operates a substantial majority of our shuttle tankers and floating storage and offtake (or *FSO*) units and all of our conventional crude oil tankers. Our growth strategy focuses on expanding our fleet of shuttle tankers and *FSO* units under long-term, fixed-rate time charters. We intend to continue our practice of acquiring shuttle tankers and *FSO* units as needed for approved projects only after the long-term charters for the projects have been awarded to us, rather than ordering vessels on a speculative basis. We intend to follow this same practice in acquiring *FPSO* units, which produce and process oil offshore in addition to providing storage and offloading capabilities. We seek to capitalize on opportunities emerging from the global expansion of the offshore transportation, storage and production sectors by selectively targeting long-term, fixed-rate time charters. We may enter into joint ventures and partnerships with companies that may provide increased access to these opportunities or may engage in vessel or business acquisitions. We plan to leverage the expertise, relationships and reputation of Teekay Corporation and its affiliates to pursue these growth opportunities in the offshore sectors and may consider other opportunities to which our competitive strengths are well suited. We view our conventional tanker fleet primarily as a source of stable cash flow as we seek to expand our offshore operations.

SIGNIFICANT DEVELOPMENTS

Equity Offerings: Acquisition of Additional 25% Interest in *OPCO*

On June 18, 2008, we completed a follow-on public offering of 7.0 million common units at a price of \$20.00 per unit, for gross proceeds of \$140.0 million. Concurrently with the public offering, Teekay Corporation acquired 3.25 million of our common units in a private placement at the same public offering price for a total cost of \$65.0 million. On July 16, 2008, the underwriters for the public offering partially exercised their over-allotment option and purchased an additional 375,000 common units for an additional \$7.5 million in gross proceeds to us.

As a result of these equity transactions, we raised gross proceeds of \$216.8 million (including our general partner's proportionate 2% capital contribution), and Teekay Corporation's ownership of us was reduced from 59.8% to 50.0% (including its indirect 2% general partner interest). We used the net proceeds from the equity offerings of approximately \$210.7 million to fund the acquisition for \$205.0 million of an additional 25% interest in *OPCO* from Teekay Corporation and to repay a portion of advances from *OPCO* to us.

Acquisition of Vessels in 2008

In June 2008, *OPCO* acquired from Teekay Corporation two 2008-built Aframax lightering tankers, the *SPT Explorer* and the *SPT Navigator*, for a total cost of approximately \$106.0 million, including assumption of debt of \$90.0 million. These two lightering tankers are specially designed to be used in ship-to-ship oil transfer operations. They operate under 10-year, fixed-rate bareboat charters to Teekay Corporation's 50% owned joint venture company, Skaugen PetroTrans, with options exercisable by the charterer to extend up to an additional five years.

In June 2007, *OPCO* exercised its option to purchase a 2001-built shuttle tanker from a third party, the *Navion Oslo*, for \$41.7 million, which previously had been in-chartered by *OPCO* and included in our shuttle tanker fleet. The vessel was delivered to *OPCO* in March 2008.

Potential Additional Shuttle Tanker, *FSO* and *FPSO* Projects

Pursuant to an omnibus agreement we entered into in connection with our initial public offering, Teekay Corporation is obligated to offer us certain shuttle tankers, *FSO* units, and *FPSO* units it may acquire in the future, provided the vessels are servicing contracts in excess of three years in length.

Teekay Corporation has ordered four Aframax shuttle tanker newbuildings, which are scheduled to deliver in 2010 and 2011, for a total delivered cost of approximately \$463.3 million. It is anticipated that these vessels will be offered to us and will be used to service either new long-term, fixed-rate contracts Teekay Corporation may be awarded prior to the vessel deliveries or *OPCO*'s contracts-of-affreightment in the North Sea.

Pursuant to the omnibus agreement, Teekay Corporation was also obligated to offer to us the *FPSO* unit, the *Varg*, within 30 days of the unit being re-chartered by Teekay Petrojarl on December 4, 2008. We have agreed to waive Teekay Corporation's obligation to offer the unit to us for charter or purchase within 30 days of the re-chartering in exchange for the right to acquire the unit, for its fair market value, at any time until December 4, 2009.

The omnibus agreement also obligated Teekay Corporation to offer to us prior to July 9, 2009, existing *FPSO* units of Teekay Petrojarl that were servicing contracts in excess of three years in length as of July 9, 2008, the date on which Teekay Corporation acquired 100% of Teekay Petrojarl. We have agreed to waive Teekay Corporation's obligation to offer these *FPSO* units to us by July 9, 2009 in exchange for the right to acquire these units, for their fair market value, at any time until July 9, 2010.

Please see Item 7 – Major Unitholders and Related Party Transactions.

Our Contracts of Affreightment and Charters

We generate revenues by charging customers for the transportation and storage of their crude oil using our vessels. Historically, these services generally have been provided under the following basic types of contractual relationships:

- *Contracts of affreightment*, whereby we carry an agreed quantity of cargo for a customer over a specified trade route within a given period of time;
- *Time charters*, whereby vessels we operate and are responsible for crewing are chartered to customers for a fixed period of time at rates that are generally fixed, but may contain a variable component based on inflation, interest rates or current market rates;
- *Bareboat charters*, whereby customers charter vessels for a fixed period of time at rates that are generally fixed, but the customers operate the vessels with their own crews; and
- *Voyage charters*, which are charters for shorter intervals that are priced on a current, or “spot,” market rate.

The table below illustrates the primary distinctions among these types of charters and contracts:

	<u>Contract of Affreightment</u>	<u>Time Charter</u>	<u>Bareboat Charter</u>	<u>Voyage Charter(1)</u>
Typical contract length	One year or more	One year or more	One year or more	Single voyage
Hire rate basis(2)	Typically daily	Daily	Daily	Varies
Voyage expenses(3)	We pay	Customer pays	Customer pays	We pay
Vessel operating expenses(3)	We pay	We pay	Customer pays	We pay
Off-hire (4)	Customer typically does not pay	Varies	Customer typically pays	Customer does not pay

- (1) Under a consecutive voyage charter, the customer pays for idle time.
- (2) “Hire” rate refers to the basic payment from the charterer for the use of the vessel.
- (3) Defined below under “Important Financial and Operational Terms and Concepts.”
- (4) “Off-hire” refers to the time a vessel is not available for service.

Important Financial and Operational Terms and Concepts

We use a variety of financial and operational terms and concepts. These include the following:

Voyage Revenues. Voyage revenues primarily include revenues from contracts of affreightment, time charters, bareboat charters and voyage charters. Voyage revenues are affected by hire rates and the number of days a vessel operates. Voyage revenues are also affected by the mix of business between contracts of affreightment, time charters, bareboat charters and voyage charters. Hire rates for voyage charters are more volatile, as they are typically tied to prevailing market rates at the time of a voyage.

Voyage Expenses. Voyage expenses are all expenses unique to a particular voyage, including any bunker fuel expenses, port fees, cargo loading and unloading expenses, canal tolls, agency fees and commissions. Voyage expenses are typically paid by the customer under time charters and bareboat charters and by the shipowner under voyage charters and contracts of affreightment. When we pay voyage expenses, they typically are added to the hire rates at an approximate cost.

Net Voyage Revenues. Net voyage revenues represent voyage revenues less voyage expenses incurred by us. Because the amount of voyage expenses we incur for a particular charter depends upon the type of charter, we use net voyage revenues to improve the comparability between periods of reported revenues that are generated by the different types of charters. We principally use net voyage revenues, a non-GAAP financial measure, because it provides more meaningful information to us about the deployment of our vessels and their performance than voyage revenues, the most directly comparable financial measure under accounting principles generally accepted in the United States (or GAAP).

Vessel Operating Expenses. Under all types of charters except for bareboat charters, the shipowner is responsible for vessel operating expenses, which include crewing, repairs and maintenance, insurance, stores, lube oils and communication expenses. The two largest components of our vessel operating expenses are crews and repairs and maintenance.

Expenses for repairs and maintenance tend to fluctuate from period to period because most repairs and maintenance typically occur during periodic drydockings. Please read “Drydocking” below. We expect these expenses to increase as the fleet matures and expands.

Time Charter Hire Expenses. Time charter hire expenses represent the cost to charter-in a vessel for a fixed period of time.

Income from Vessel Operations. To assist us in evaluating operations by segment, we sometimes analyze the income we receive from each segment after deducting operating expenses, but prior to the deduction of interest expense, taxes, foreign currency exchange gains and losses and other income and losses.

Drydocking. We must periodically drydock our shuttle tankers and conventional oil tankers for inspection, repairs and maintenance and any modifications to comply with industry certification or governmental requirements. We may drydock FSO units if we desire to qualify them for shipping classification. Generally, each shuttle tanker and conventional oil tanker is drydocked every two and a half to five years, depending upon the type of vessel and its age. We capitalize a substantial portion of the costs incurred during drydocking and amortize those costs on a straight-line basis from the completion of a drydocking to the estimated completion of the next drydocking. We expense as incurred costs for routine repairs and

maintenance performed during drydocking that do not improve or extend the useful lives of the assets. The number of drydockings undertaken in a given period and the nature of the work performed determine the level of drydocking expenditures.

Depreciation and Amortization. Depreciation and amortization expense typically consists of:

- charges related to the depreciation of the historical cost of our fleet (less an estimated residual value) over the estimated useful lives of the vessels;
- charges related to the amortization of drydocking expenditures over the estimated number of years to the next scheduled drydocking; and
- charges related to the amortization of the fair value of contracts of affreightment where amounts have been attributed to those items in acquisitions; these amounts are amortized over the period in which the asset is expected to contribute to future cash flows.

Revenue Days. Revenue days are the total number of calendar days our vessels were in our possession during a period, less the total number of off-hire days during the period associated with major repairs, or drydockings. Consequently, revenue days represent the total number of days available for the vessel to earn revenue. Idle days, which are days when the vessel is available to earn revenue, yet is not employed, are included in revenue days. We use revenue days to show changes in net voyage revenues between periods.

Calendar-Ship-Days. Calendar-ship-days are equal to the total number of calendar days that our vessels were in our possession during a period. We use calendar-ship-days primarily to highlight changes in vessel operating expenses, time charter hire expense and depreciation and amortization. For periods prior to our initial public offering in December 2006, calendar-ship days are based on OPCO's owned and chartered-in fleet, excluding vessels owned by OPCO's five 50% owned subsidiaries. For periods on or after our initial public offering, calendar-ship days are based on our and OPCO's owned and chartered-in fleet, including vessels owned by our 50% owned subsidiaries, as OPCO obtained control of five of these subsidiaries as of December 1, 2006, and we purchased a 50% interest in one subsidiary in July 2007.

VOC Equipment. We assemble, install, operate and lease equipment that reduces volatile organic compound emissions (or *VOC equipment*) during loading, transportation and storage of oil and oil products. Leasing of the VOC equipment is accounted for as a direct financing lease, with lease payments received being allocated between the net investment in the lease and other income using the effective interest method so as to produce a constant periodic rate of return over the lease term.

Items You Should Consider When Evaluating Our Results

You should consider the following factors when evaluating our historical financial performance and assessing our future prospects:

- **Our financial results reflect the results of the interests in vessels acquired from Teekay Corporation for all periods the vessels were under common control.** In July 2007, we acquired from Teekay Corporation ownership of its 100% interest in the 2000-built shuttle tanker *Navion Bergen* and its 50% interest in the 2006-built shuttle tanker *Navion Gothenburg*. The acquisitions included the assumption of debt, related interest rate swap agreements and Teekay Corporation's rights and obligations under 13-year, fixed-rate bareboat charters. In October 2007, we acquired from Teekay Corporation its interest in the FSO unit *Dampier Spirit*, along with its 7-year fixed-rate time-charter. In June 2008, we acquired from Teekay Corporation its interests in two 2008-built Aframax lightering tankers, the *SPT Explorer* and the *SPT Navigator*. This acquisition included the assumption of debt and Teekay Corporation's rights and obligations under the 10-year, fixed-rate bareboat charters (with options exercisable by the charterer to extend up to an additional five years).

These transactions were deemed to be business acquisitions between entities under common control. Accordingly, we have accounted for these transactions in a manner similar to the pooling of interest method. Under this method of accounting, our financial statements prior to the date the interests in these vessels were actually acquired by us are retroactively adjusted to include the results of these acquired vessels. The periods retroactively adjusted include all periods that we and the acquired vessels were both under common control of Teekay Corporation and had begun operations. As a result, our statements of income (loss) for the years ended December 31, 2008, 2007 and 2006 reflect these vessels and their results of operations, referred to herein as the *Dropdown Predecessor*, as if we had acquired them when each respective vessel began operations under the ownership of Teekay Corporation. These vessels began operations on April 16, 2007 (*Navion Bergen*), July 24, 2007 (*Navion Gothenburg*), March 15, 1998 (*Dampier Spirit*), January 7, 2008 (*SPT Explorer*) and March 28, 2008 (*SPT Navigator*).

- **The size of our fleet continues to change.** Our results of operations reflect changes in the size and composition of our fleet due to certain vessel deliveries and vessel dispositions. For instance, the average number of owned vessels in our conventional tanker fleet increased from 9 in 2007 to 11 in 2008. Please read "— Results of Operations" below for further details about vessel dispositions and deliveries. Due to the nature of our business, we expect our fleet to continue to fluctuate in size and composition.
- **Our vessel operating costs are facing industry-wide cost pressures.** The shipping industry is experiencing a global manpower shortage due to significant growth in the world fleet. This shortage has resulted in crewing wage increases during 2007 and 2008 and has continued to date during 2009.
- **Our financial results of operations are affected by fluctuations in currency exchange rates.** Under GAAP, all foreign currency-denominated monetary assets and liabilities, such as cash and cash equivalents, accounts receivable, accounts payable, advances from affiliates and deferred income taxes are revalued and reported based on the prevailing exchange rate at the end of the period. OPCO has entered into services agreements with subsidiaries of Teekay Corporation whereby the subsidiaries operate and crew the vessels. Under the services agreements, the applicable subsidiaries of Teekay Corporation are paid in U.S. dollars for reasonable direct and indirect expenses, incurred in providing the services. A substantial majority of those expenses are in Norwegian Kroner. The Teekay Corporation subsidiaries were paid under the services agreements based on a fixed U.S. dollar / Norwegian Kroner exchange rate until December 31, 2008. The exchange rate is no longer fixed under these agreements, which may result in increased payments by us if the strength of the U.S. Dollar declines relative to the Norwegian Kroner.

- **Our operations are seasonal.** Historically, the utilization of shuttle tankers in the North Sea is higher in the winter months, as favorable weather conditions in the summer months provide opportunities for repairs and maintenance to our vessels and to the offshore oil platforms. Downtime for repairs and maintenance generally reduces oil production and, thus, transportation requirements.
- **The amount and timing of drydockings of our vessels can significantly affect our revenues between periods.** During 2006 to 2008, our vessels were offhire at various points of time due to scheduled and unscheduled maintenance. The financial impact from these periods of offhire, if material, is explained in further detail below in "-- Results of Operations".

We manage our business and analyze and report our results of operations on the basis of three business segments: the shuttle tanker segment, the conventional tanker segment and the FSO segment.

Year Ended December 31, 2008 versus Year Ended December 31, 2007

Shuttle Tanker Segment

Our shuttle tanker fleet consists of 37 vessels that operate under fixed-rate contracts of affreightment, time charters and bareboat charters. Of the 37 shuttle tankers, 25 are owned by OPCO (including 5 through 50% owned subsidiaries), 10 are chartered-in by OPCO and 2 are owned by us (including one through a 50% owned subsidiary). All of these shuttle tankers provide transportation services to energy companies, primarily in the North Sea and Brazil. Our shuttle tankers service the conventional spot market from time to time where spot rates during 2009 have experienced significant declines compared to 2008 as a result of the contraction in the global economy.

The following table presents our shuttle tanker segment's operating results for the years ended December 31, 2008 and 2007, and compares its net voyage revenues (which is a non-GAAP financial measure) for the years ended December 31, 2008 and 2007 to voyage revenues, the most directly comparable GAAP financial measure, for the same periods. The following table also provides a summary of the changes in calendar-ship-days by owned and chartered-in vessels for our shuttle tanker segment:

(in thousands of U.S. dollars, except calendar-ship-days and percentages)	Year Ended December 31,		% Change
	2008	2007	
Voyage revenues	650,896	590,611	10.2
Voyage expenses	169,578	114,157	48.5
Net voyage revenues	481,318	476,454	1.0
Vessel operating expenses	132,415	103,809	27.6
Time-charter hire expense	132,234	150,463	(12.1)
Depreciation and amortization	91,846	86,502	6.2
General and administrative ⁽¹⁾	51,996	50,776	2.4
Income from vessel operations	72,827	84,904	(14.2)
Calendar-Ship-Days			
Owned Vessels	9,765	9,180	6.4
Chartered-in Vessels	3,624	4,297	(15.7)
Total	13,389	13,477	(0.7)

(1)Includes direct general and administrative expenses and indirect general and administrative expenses (allocated to the shuttle tanker segment based on estimated use of corporate resources).

The average size of our owned shuttle tanker fleet increased for 2008 compared to 2007, primarily due to:

- the acquisition in July 2007 of a 2000-built shuttle tanker (the *Navion Bergen*) and a 50% interest in a 2006-built shuttle-tanker (the *Navion Gothenburg*) (or the *2007 Shuttle Tanker Acquisitions*). However, as a result of the inclusion of the Dropdown Predecessor, the *Navion Bergen* had been included for accounting purposes in our results as if it had been acquired on April 16, 2007, when it completed its conversion and began operations as a shuttle tanker for Teekay Corporation. The *Navion Gothenburg* completed its conversion and began operations as a shuttle tanker concurrently with its acquisition by us in July 2007. Please read "—Items You Should Consider When Evaluating Our Results of Operations— Our financial results reflect the results of the interests in vessels acquired from Teekay Corporation for all periods the vessels were under common control" above; and
- the purchase of a previously in-chartered shuttle tanker, which was delivered to us in late March 2008 (or the *2008 Shuttle Tanker Acquisition*)

The average size of our chartered-in shuttle tanker fleet decreased in 2008 compared to 2007, primarily due to:

- the redelivery of two chartered-in vessels back to their owners in December 2007 and June 2008, respectively; and
- the 2008 Shuttle Tanker Acquisition.

Net Voyage Revenues. Net voyage revenues increased slightly for 2008 from 2007, primarily due to:

- an increase of \$10.2 million due to the 2007 Shuttle Tanker Acquisitions (including the impact of the Dropdown Predecessor);
- an increase of \$9.6 million due to more revenue days from shuttle tankers servicing contracts of affreightment and the conventional spot market and earning a higher average daily charter rate than the same period last year;
- an increase of \$2.5 million due to the redeployment of one shuttle tanker from servicing contracts of affreightment to a time-charter effective October 2007, and earning a higher average daily charter rate than for the same period last year; and

- an increase of \$2.3 million due to the recovery of certain Norwegian environmental taxes as voyage expenses from our customers on the Heidrun oil field in 2008;

partially offset by

- a decrease of \$10.0 million due to declining oil production at mature oil fields in the North Sea that are serviced by certain shuttle tankers on contracts of affreightment;
- a decrease of \$3.9 million due to an increased number of offhire days resulting from an increase in scheduled drydockings and unexpected repairs performed for 2008 compared to 2007;
- a decrease of \$3.4 million due to customer performance claims under the terms of charter party agreements; and
- a decrease of \$3.0 million due to an increase in bunker costs which are not passed on to the charterer under certain contracts.

Vessel Operating Expenses. Vessel operating expenses increased for 2008 from 2007, primarily due to:

- an increase of \$13.6 million in salaries for crew and officers primarily due to general wage escalations and a change in the crew rotation system;
- an increase of \$5.3 million relating to an increase in services due to the rising cost of consumables, lubes, and freight;
- an increase of \$4.4 million relating to the 2008 Shuttle Tanker Acquisition;
- an increase of \$3.4 million relating to repairs and maintenance performed for certain vessels those periods; and
- an increase of \$1.4 million relating to the unrealized change in fair value of our foreign currency forward contracts.

Time-Charter Hire Expense. Time-charter hire expense decreased for 2008 from 2007, primarily due to:

- a decrease of \$17.4 million due to redelivery of two chartered-in vessels back to their owners in December 2007 and June 2008, respectively; and
- a decrease of \$9.0 million due to the 2008 Shuttle Tanker Acquisition;

partially offset by

- by an increase of \$8.0 million due to an increase in spot chartered-in vessels during 2008.

Depreciation and Amortization. Depreciation and amortization expense increased for 2008 from 2007, primarily due to:

- an increase of \$2.8 million due to the 2007 Shuttle Tanker Acquisitions (including the impact of the Dropdown Predecessor); and
- an increase of \$1.6 million due to the 2008 Shuttle Tanker Acquisition.

Conventional Tanker Segment

OPCO owns 11 Aframax conventional crude oil tankers, 9 of which operate under fixed-rate time charters with Teekay Corporation. The remaining 2 vessels, which have additional equipment for lightering, operate under fixed-rate bareboat charters with Skaugen PetroTrans, Teekay Corporation's 50%-owned joint venture.

The following table presents our conventional tanker segment's operating results for the years ended December 31, 2008 and 2007, and compares its net voyage revenues (which is a non-GAAP financial measure) for the years ended December 31, 2008 and 2007 to voyage revenues, the most directly comparable GAAP financial measure, for the same periods. The following table also provides a summary of the changes in calendar-ship-days for our conventional tanker segment:

(in thousands of U.S. dollars, except calendar-ship-days and percentages)	Year Ended December 31,		% Change
	2008	2007	
Voyage revenues	153,200	135,922	12.7
Voyage expenses	53,722	36,594	46.8
Net voyage revenues	99,478	99,328	0.2
Vessel operating expenses	25,156	24,175	4.1
Depreciation and amortization	22,901	21,324	7.4
General and administrative ⁽¹⁾	8,674	7,828	10.8
Income from vessel operations	42,747	46,001	(7.1)
Calendar-Ship-Days Owned Vessels	3,931	3,405	15.4

(1) Includes direct general and administrative expenses and indirect general and administrative expenses (allocated to the conventional tanker segment based on estimated use of corporate resources).

The average size of the conventional crude oil tanker fleet increased for 2008 compared to 2007, primarily due:

- In June 2008, OPCO acquired the lightering tankers *SPT Explorer* and *SPT Navigator* (collectively, the *2008 Conventional Tanker Acquisitions*), which operate under fixed-rate bareboat charters to Teekay Corporation's 50% owned joint venture company, Skaugen PetroTrans. (However, as a result of the inclusion of the Dropdown Predecessor, the *SPT Explorer* and the *SPT Navigator* have been included for accounting purposes in our results as if they were acquired on January 7, 2008 and March 28, 2008, respectively, when they completed construction and began operations as conventional tankers for Teekay Corporation. Please read "—Items You Should Consider When Evaluating Our Results of Operations— Our financial results reflect the results of the interests in vessels acquired from Teekay Corporation for all periods the vessels were under common control" above);

partially offset by

- transfer of the *Navion Saga* to the FSO segment as a result of the completion of its conversion to an FSO unit and commencing a three-year FSO time charter contract in early May 2007 (prior to the completion of the vessel's conversion to an FSO unit, it was included as a conventional crude oil tanker within the conventional tanker segment).

Net Voyage Revenues. Net voyage revenues increased slightly for 2008 compared to 2007, primarily due:

- an increase of \$8.6 million due to the 2008 Conventional Tanker Acquisitions (including the impact of the Dropdown Predecessor);
- an increase of \$3.6 million due to an increase in the daily hire rates for all nine time-charter contracts with Teekay Corporation; and
- a relative increase of \$1.9 million due to fewer scheduled drydockings;

partially offset by

- a decrease of \$10.1 million in net bunker revenues (under the terms of eight of the nine time-charter contracts with Teekay Corporation, OPCO is responsible for the bunker fuel expenses and the approximate amounts of these expenses are added to the daily hire rate; during the annual review of the daily hire rate in the third quarter of 2007, the rate per day was adjusted downwards based on the average daily bunker consumption for the preceding year); and
- a decrease of \$3.4 million due to the transfer of the *Navion Saga* to the FSO segment in early May 2007.

Vessel Operating Expenses. Vessel operating expenses increased for 2008 from 2007, primarily due to:

- an increase of \$1.5 million in salaries for crew and officers, primarily due to general wage escalations; and
- an increase of \$1.1 million due to an increase in prices for consumables, freight and lubricants;

partially offset by

- a decrease of \$1.4 million due to the transfer of the *Navion Saga* to the FSO segment in early May 2007.

Depreciation and Amortization. Depreciation and amortization expense increased for 2008 from 2007, primarily due to:

- an increase of \$2.8 million due to the 2008 Conventional Tanker Acquisitions (including the impact of the Dropdown Predecessor);

partially offset by

- a decrease of \$1.1 million from the transfer of the *Navion Saga* to the FSO segment in early May 2007.

FSO Segment

We own five FSO units that operate under fixed-rate time charters or fixed-rate bareboat charters. FSO units provide an on-site storage solution to oil field installations that have no oil storage facilities or that require supplemental storage.

The following table presents our FSO segment's operating results for the years ended December 31, 2008 and 2007, and compares its net voyage revenues (which is a non-GAAP financial measure) for the years ended December 31, 2008 and 2007 to voyage revenues, the most directly comparable GAAP financial measure, for the same periods. The following table also provides a summary of the changes in calendar-ship-days for our FSO segment:

(in thousands of U.S. dollars, except calendar-ship-days and percentages)	Year Ended December 31,		% Change
	2008	2007	
Voyage revenues	68,396	58,670	16.6
Voyage expenses	1,729	886	95.1
Net voyage revenues	66,667	57,784	15.4
Vessel operating expenses	26,845	21,676	23.8
Depreciation and amortization	23,690	16,544	43.2
General and administrative ⁽¹⁾	3,560	3,800	(6.3)
Income from vessel operations	12,572	15,764	(20.2)
Calendar-Ship-Days			
Owned Vessels	1,830	1,705	7.3

- (1) Includes direct general and administrative expenses and indirect general and administrative expenses (allocated to the FSO segment based on estimated use of corporate resources).

During 2007, we were deemed to have operated four FSO units, including the *Dampier Spirit* as a result of the inclusion of the Dropdown Predecessor, which we acquired from Teekay Corporation in October 2007. The *Dampier Spirit* has been included in our results as if it was acquired on January 1, 2007. Please read "—Items You Should Consider When Evaluating Our Results of Operations— Our financial results reflect the results of the interests in vessels acquired from Teekay Corporation for all periods the vessels were under common control" above.

A fifth FSO unit, the *Navion Saga*, was operated as a conventional crude oil tanker within our conventional tanker segment until May 2007, as discussed above.

Net Voyage Revenues. Net voyage revenues increased during for 2008 from 2007, primarily due to:

- an increase of \$6.9 million from the inclusion of the *Navion Saga* in the FSO segment from May 2007; and
- a relative increase of \$3.3 million from the *Dampier Spirit* being offhire for 110 days during the first half of 2007 due to a scheduled drydock;

partially offset by

- a relative decrease due to the receipt of a mobilization fee of \$3.5 million during 2007.

Vessel Operating Expenses. Vessel operating expenses increased for 2008 from 2007, primarily due to the inclusion of the *Navion Saga* in the FSO segment from May 2007.

Depreciation and Amortization. Depreciation and amortization expense increased for 2008 from 2007, primarily due to the inclusion of the *Navion Saga* in the FSO segment from May 2007.

Other Operating Results

General and Administrative Expenses. General and administrative expenses have increased to \$64.2 million in 2008 from \$62.4 million for 2007, primarily due to:

- an increase of \$6.8 million, primarily due to an increase in crew training costs;

partially offset by

- a decrease of \$5.4 million in management fees payable to a subsidiary of Teekay Corporation for services rendered to us during 2008. Included in the management fee is an allocation of accrued costs relating to a long-term incentive plan (the Vision Incentive Plan or VIP) maintained by Teekay Corporation for the benefit of its senior management, some of whom provide services to us. As a result of decreases in Teekay Corporation's share price, there was a decrease in the accrual of the long-term incentive plan compensation expense for 2008.

Interest Expense. Interest expense increased to \$215.7 million for 2008, from \$126.3 million for 2007, primarily due to:

- an increase of \$86.8 million relating to the unrealized change in fair value of our interest rate swaps;
- an increase of \$7.0 million due to the assumption of debt relating to the 2007 Shuttle Tanker Acquisitions and the 2008 Conventional Tanker Acquisitions; and
- an increase of \$4.3 due to the increase in debt relating to the purchase of the *Dampier Spirit*,

partially offset by

- a decrease of \$5.4 million relating to the timing difference in the reset dates between OPCO's loans and related interest rate swaps; and
- a decrease of \$4.1 million relating to the scheduled repayment of debt during 2007 and 2008 for five of our subsidiaries.

We have not designated our interest rate swaps as hedges for accounting purposes and as such, the unrealized changes in the fair values of the swaps are reflected in interest expense in our consolidated statements of income (loss).

Foreign Currency Exchange Gains (Losses). Foreign currency exchange gains was \$4.3 million for 2008 compared to a \$11.7 million loss for 2007. Our foreign currency exchange losses and gains, substantially all of which are unrealized, are due primarily to the relevant period-end revaluation of Norwegian Kroner-denominated monetary assets and liabilities for financial reporting purposes. Gains reflect a stronger U.S. Dollar against the Kroner on the date of revaluation or settlement compared to the rate in effect at the beginning of the period. Losses reflect a weaker U.S. Dollar against the Norwegian Kroner on the date of revaluation or settlement compared to the rate in effect at the beginning of the period.

Income Tax Recovery (Expense). Income tax recovery was \$56.7 million for 2008 compared to \$10.5 million for 2007. The \$46.2 million increase to income tax recoveries was primarily due to an increase in deferred income tax recoveries relating to unrealized foreign exchange translation losses.

Other Income. Other income for 2008 and 2007 was \$11.9 million and \$10.4 million, respectively, which was primarily comprised of leasing income from our VOC equipment.

Net (Loss) Income. As a result of the foregoing factors, net income decreased to a loss of \$17.6 million for 2008, from income of \$4.0 million for 2007.

Year Ended December 31, 2007 versus Year Ended December 31, 2006

Shuttle Tanker Segment

The following table presents our shuttle tanker segment's operating results for the years ended December 31, 2007 and 2006, and compares its net voyage revenues (which is a non-GAAP financial measure) for the years ended December 31, 2007 and 2006 to voyage revenues, the most directly comparable GAAP financial measure, for the same periods. The following table also provides a summary of the changes in calendar-ship-days by owned and chartered-in vessels for our shuttle tanker segment:

(in thousands of U.S. dollars, except calendar-ship-days and percentages)	Year Ended December 31,		% Change
	2007	2006	
Voyage revenues	590,611	535,972	10.2
Voyage expenses	114,157	88,446	29.1
Net voyage revenues	476,454	447,526	6.5
Vessel operating expenses	103,809	80,307	29.3
Time-charter hire expense	150,463	165,614	(9.1)
Depreciation and amortization	86,502	71,367	21.2
General and administrative ⁽¹⁾	50,776	50,353	0.8
Gain on sale of vessels and equipment - net of writedowns	-	(4,778)	(100.0)
Income from vessel operations	84,904	84,663	0.3
Calendar-Ship-Days			
Owned Vessels	9,180	7,559	21.4
Chartered-in Vessels	4,297	4,824	(10.9)
Total	13,477	12,383	8.8

(1) Includes direct general and administrative expenses and indirect general and administrative expenses (allocated to the shuttle tanker segment based on estimated use of corporate resources).

The average size of our owned shuttle tanker fleet increased for 2007 compared to 2006, primarily due to:

- the consolidation into our results of the five vessels owned by OPCO's 50% owned subsidiaries, effective December 1, 2006 upon amendments to the applicable operating agreements that granted OPCO control of the subsidiaries (the *Consolidation of 50%-Owned Subsidiaries*). Prior to December 1, 2006, these entities were equity accounted for as joint ventures. Please read "—Items You Should Consider When Evaluating Our Results of Operations— Amendments to certain operating agreements in December 2006 have resulted in five 50% owned subsidiaries being consolidated with us under GAAP" above; and
- the acquisition in July 2007 of a 2000-built shuttle tanker (the *Navion Bergen*) and a 50% interest in a 2006-built shuttle-tanker (the *Navion Gothenburg*) (the *2007 Shuttle Tanker Acquisitions*). (However, as a result of the inclusion of the Dropdown Predecessor, the *Navion Bergen* had been included for accounting purposes in our results as if it had been acquired on April 16, 2007, when it completed its conversion and began operations as a shuttle tanker for Teekay Corporation. The *Navion Gothenburg* completed its conversion and began operations as a shuttle tanker concurrently with its acquisition in July 2007. Please read "—Items You Should Consider When Evaluating Our Results of Operations— Our financial results reflect the results of the interests in vessels acquired from Teekay Corporation for all periods the vessels were under common control" above);

partially offset by

- the sale of a 1981-built shuttle tanker (the *Nordic Laurita*) in July 2006 to a third party and the sale of a 1987-built shuttle tanker (the *Nordic Trym*) to Teekay Corporation in November 2006 (collectively, the *2006 Shuttle Tanker Dispositions*).

The average size of our chartered-in shuttle tanker fleet decreased in 2007 compared to 2006, primarily due to:

- the redelivery of one chartered-in vessel back to its owner in April 2006; and
- the sale in July 2006 to Teekay Corporation of a time charter-in contract for a 1992-built shuttle tanker (the *Borga*).

Net Voyage Revenues. Net voyage revenues increased for 2007 from 2006, primarily due to:

- an increase of \$40.8 million due to the Consolidation of 50%-Owned Subsidiaries;
- an increase of \$12.2 million due to the 2007 Shuttle Tanker Acquisitions (including the impact of the Dropdown Predecessor); and
- an increase of \$3.6 million due to the renewal of certain vessels on time charter contracts at higher daily rates during 2006;

partially offset by

- a decrease of \$13.6 million in revenues due to (a) fewer revenue days for shuttle tankers servicing contracts of affreightment during 2007 due to a decline in oil production from mature oil fields in the North Sea and (b) the redeployment of idle shuttle tankers servicing contracts

of affreightment in the conventional spot market at a lower average charter rate during the fourth quarter of 2007 due to a weaker spot tanker market;

- a decrease of \$7.6 million due to the 2006 Shuttle Tanker Dispositions;
- a decrease of \$4.4 million due to the sale of the time charter-in contract for the *Borga*; and
- a decrease of \$2.9 million from the redelivery of one chartered-in vessel to its owner in April 2006.

Vessel Operating Expenses. Vessel operating expenses increased for 2007 from 2006, primarily due to:

- an increase of \$17.3 million due to the Consolidation of 50%-Owned Subsidiaries;
- an increase of \$7.0 million in salaries for crew and officers primarily due to general wage escalations from the renegotiation of seafarer contracts, changes in crew composition and a change in the crew rotation system; and
- an increase of \$1.9 million relating to an increase in services due to the rising cost of consumables, lubes, and freight during 2007;

partially offset by

- a decrease of \$3.2 million due to the 2006 Shuttle Tanker Dispositions.

Time-Charter Hire Expense. Time-charter hire expense decreased for 2007 from 2006, primarily due to the decrease in the average number of vessels chartered-in.

Depreciation and Amortization. Depreciation and amortization expense increased for 2007 from 2006, primarily due to:

- an increase of \$13.7 million due to the Consolidation of 50%-Owned Subsidiaries;
- an increase of \$4.1 million due to the 2007 Shuttle Tanker Acquisitions (including the impact of the Dropdown Predecessor); and
- an increase of \$3.9 million from the amortization of vessel upgrades and drydock costs incurred during 2006 and 2007;

partially offset by

- a decrease of \$5.7 million relating to the 2006 Shuttle Tanker Dispositions.

Gain on sale of vessels equipment - net of writedowns. Gain on sale of vessels and equipment - net of writedowns for 2006 was a net gain of \$4.8 million, which was comprised primarily of:

- a \$6.4 million gain relating to the sale of a 1981-built shuttle tanker (the *Nordic Laurita*) in July 2006;

partially offset by

- a \$2.2 million writedown in 2006 of certain offshore equipment servicing a marginal oil field that was prematurely shut down in June 2005 due to lower than expected oil production. (This writedown occurred due to a reassessment of the estimated net realizable value of the equipment and follows a \$12.2 million writedown in 2005 arising from the early termination of a contract for the equipment (some of this equipment was re-deployed on another field in October 2005)).

Conventional Tanker Segment

The following table presents our conventional tanker segment's operating results for the years ended December 31, 2007 and 2006, and compares its net voyage revenues (which is a non-GAAP financial measure) for the years ended December 31, 2007 and 2006 to voyage revenues, the most directly comparable GAAP financial measure, for the same periods. The following table also provides a summary of the changes in calendar-ship-days for our conventional tanker segment:

(in thousands of U.S. dollars, except calendar-ship-days and percentages)	Year Ended December 31,		% Change
	2007	2006	
Voyage revenues	135,922	70,056	94.0
Voyage expenses	36,594	4,892	648.0
Net voyage revenues	99,328	65,164	52.4
Vessel operating expenses	24,175	19,378	24.8
Depreciation and amortization	21,324	21,212	0.5
General and administrative ⁽¹⁾	7,828	11,789	(33.6)
Restructuring charge	-	832	(100.0)
Income from vessel operations	46,001	11,953	284.8
Calendar-Ship-Days Owned Vessels	3,405	3,650	(6.7)

- (1) Includes direct general and administrative expenses and indirect general and administrative expenses (allocated to the conventional tanker segment based on estimated use of corporate resources).

The average size of the conventional crude oil tanker fleet decreased for 2007 compared to 2006, primarily due to the transfer of the *Navion Saga* from the conventional tanker segment to the FSO segment as a result of the completion of its conversion to an FSO unit and commencing a three-year FSO time charter contract in early May 2007.

Net Voyage Revenues. Net voyage revenues increased for 2007 from 2006, primarily due to higher hire rates earned by the nine owned Aframax conventional tankers on time charters with a subsidiary of Teekay Corporation (please read “— *Items You Should Consider When Evaluating Our Results – Our financial results of operations reflect different time charter terms for OPCO’s nine conventional tankers*”).

Vessel Operating Expenses. Vessel operating expenses increased for 2007 from 2006, primarily due to an increase in salaries for crew and officers as a result of general wage escalations and an increase in services and repairs and maintenance. In addition, one of the nine owned Aframax conventional tankers was employed by Teekay Corporation during 2006 on a short-term bareboat-charter under which the customer was responsible for vessel operating expenses, and was employed during 2007 on a time-charter contract under which we are responsible for vessel operating expenses.

Depreciation and Amortization. Depreciation and amortization expense increased slightly for 2007 from 2006, primarily due to an increase from the amortization of drydock costs incurred during 2007, partially offset by a \$1.3 million decrease due to the transfer of the *Navion Saga* to the FSO segment in early May 2007.

FSO Segment

The following table presents our FSO segment’s operating results for the years ended December 31, 2007 and 2006, and compares its net voyage revenues (which is a non-GAAP financial measure) for the years ended December 31, 2007 and 2006 to voyage revenues, the most directly comparable GAAP financial measure, for the same periods. The following table also provides a summary of the changes in calendar-ship-days for our FSO segment:

(in thousands of U.S. dollars, except calendar-ship-days and percentages)	Year Ended December 31,		% Change
	2007	2006	
Voyage revenues	58,670	35,883	63.5
Voyage expenses	886	1,085	(18.3)
Net voyage revenues	57,784	34,798	66.1
Vessel operating expenses	21,676	12,603	72.0
Depreciation and amortization	16,544	11,970	38.2
General and administrative ⁽¹⁾	3,800	3,049	24.6
Income from vessel operations	15,764	7,176	119.7
Calendar-Ship-Days Owned Vessels	1,705	1,460	16.8

- (1) Includes direct general and administrative expenses and indirect general and administrative expenses (allocated to the FSO segment based on estimated use of corporate resources).

During 2006, we were deemed to have operated four FSO units, including the *Dampier Spirit* as a result of the inclusion of the Dropdown Predecessor, which we acquired from Teekay Corporation in October 2007. The *Dampier Spirit* has been included in our results as if it was acquired on March 15, 1998, when it completed its conversion and began operations as a FSO unit for Teekay Corporation. Please read “—*Items You Should Consider When Evaluating Our Results of Operations— Our financial results reflect the results of the interests in vessels acquired from Teekay Corporation for all periods the vessels were under common control*” above.

As described above, a fifth FSO unit, the *Navion Saga*, was transferred from the conventional tanker segment to the FSO segment as a result of the completion of its conversion to an FSO unit and commencing a three-year FSO time charter contract in early May 2007. The change in operating results for the FSO segment from 2006 to 2007 was primarily due to the inclusion of the *Navion Saga*.

Other Operating Results

General and Administrative Expenses. General and administrative expenses decreased slightly to \$62.4 million for 2007, from \$65.2 million for 2006, primarily due to:

- a decrease in management fees owing to subsidiaries of Teekay Corporation (prior to our initial public offering, general and administrative expenses were allocated based on OPCO’s proportionate share of Teekay Corporation’s total ship-operating (calendar) days for each of the periods presented; since the initial public offering, we have incurred general and administrative expenses primarily through services agreements between us, OPCO and certain of its subsidiaries and subsidiaries of Teekay Corporation);

partially offset by

- an increase of \$2.4 million relating to additional expenses as a result of our being a publicly-traded limited partnership since our initial public offering in December 2006.

Interest Expense. Interest expense increased to \$126.3 million for 2007, from \$66.1 million for 2006, primarily due to:

- an increase of \$48.9 million relating to the unrealized change in fair value of our interest rate swaps;
- an increase of \$35.9 million relating to a full year of interest incurred on debt under a revolving credit facility OPCO entered into during the fourth quarter of 2006;
- an increase of \$11.3 million due to the Consolidation of 50%-Owned Subsidiaries; and
- increase of \$4.7 million due to the assumption of debt relating to the 2007 Shuttle Tanker Acquisitions (including the *Navion Bergen's* interest expense from April 16, 2007 until we acquired it on July 1, 2007);

partially offset by

- a decrease of \$14.2 million in interest incurred on a Norwegian Kroner-denominated loan owing by a subsidiary of OPCO to Teekay Corporation from October 2006 until our initial public offering in December 2006 (Teekay Corporation sold this loan receivable to OPCO immediately before our initial public offering);
- a decrease of \$12.9 million relating to the settlement of interest-bearing advances from affiliates during the fourth quarter of 2006;
- a decrease of \$7.5 million relating to interest incurred under a revolving credit facility that was prepaid and cancelled prior to our initial public offering; and
- a decrease of \$6.3 million relating to interest incurred by Teekay Offshore Partners Predecessor on one of its revolving credit facilities, which was not transferred to OPCO prior to our initial public offering.

We have not designated our interest rate swaps as hedges for accounting purposes, and as such, the unrealized changes in fair value of the swaps are reflected in interest expense in our consolidated statements of income (loss).

Equity Income From Joint Ventures. Equity income from OPCO's 50% joint ventures was \$6.3 million for 2006. On December 1, 2006, the operating agreements for these joint ventures were amended, resulting in OPCO obtaining control of these entities and, consequently, OPCO has consolidated these entities since December 1, 2006.

Foreign Currency Exchange Losses. Foreign currency exchange loss was \$11.7 million for 2007 compared to a \$66.3 million loss for 2006. In 2006, the foreign currency exchange loss of \$66.3 million was primarily due to the revaluation of Norwegian Kroner-denominated advances from affiliates prior to our initial public offering. These foreign currency exchange losses and gains, substantially all of which were unrealized, are due primarily to the relevant period-end revaluation of Norwegian Kroner-denominated monetary assets and liabilities for financial reporting purposes. Gains reflect a stronger U.S. Dollar against the Kroner on the date of revaluation or settlement compared to the rate in effect at the beginning of the period. Losses reflect a weaker U.S. Dollar against the Kroner on the date of revaluation or settlement compared to the rate in effect at the beginning of the period.

Income Tax Recovery (Expense). Income tax recovery was \$10.5 million for 2007 compared to an income tax expense of \$3.4 million for 2006. The \$13.9 million increase to income tax recoveries was primarily due to deferred income tax recoveries resulting from the financial restructuring of our Norwegian shuttle tanker operations during 2006, partially offset by an increase in deferred income tax expense relating to unrealized foreign exchange translation gains.

Other Income. Other income for 2007 and 2006 was \$10.4 million and \$8.7 million, respectively, which was primarily comprised of leasing income from our VOC equipment.

Net Loss from Discontinued Operations. On July 1, 2006, OPCO sold Navion Shipping Ltd. to a subsidiary of Teekay Corporation for \$53.7 million. At the time of the sale, all of OPCO's chartered-in conventional tankers were chartered-in by Navion Shipping Ltd. and subsequently time chartered to a subsidiary of Teekay Corporation at charter rates that provided a fixed 1.25% profit margin. These chartered-in conventional tankers were operated in the spot market by the subsidiary of Teekay Corporation. These operations prior to July 1, 2006 were reported within the conventional tanker segment. Net loss from discontinued operations was \$10.5 million for 2006.

Net Income (Loss). As a result of the foregoing factors, net income increased to \$4.0 million for 2007, from a net loss of \$18.2 million for 2006.

Restructuring Costs

During 2009 we intend to reflag seven of our vessels from Norwegian flag to Bahamian flag and change the nationality mix of our crews. Under this plan, we will record and pay the restructuring charges of approximately \$4.4 million during 2009. The actual charges are recorded in the period in which we commit to a formalized restructuring plan or execute the specific actions contemplated by the program and all criteria for restructuring charge recognition under the applicable accounting guidance have been met. We expect the reflagging will result in a reduction in our crewing costs for these vessels.

Liquidity and Capital Resources

Liquidity and Cash Needs

As at December 31, 2008, our total cash and cash equivalents were \$131.5 million, compared to \$121.2 million at December 31, 2007. Our total liquidity, including cash, cash equivalents and undrawn long-term borrowings, was \$274.2 million as at December 31, 2008, compared to \$286.7 million as at December 31, 2007. The decrease in liquidity was primarily the result of the \$16.7 million cash payment made to Teekay Corporation for the purchase of the subsidiaries that own the lightering tankers, *SPT Explorer* and *SPT Navigator*, the payment of cash distributions by us and OPCO and expenditures for vessels and equipment; partially offset by cash generated by our operating activities.

In addition to distributions on our equity interests, our primary short-term liquidity needs are to fund general working capital requirements and drydocking expenditures, while our long-term liquidity needs primarily relate to expansion and investment capital expenditures and maintenance capital expenditures and debt repayment. Expansion capital expenditures are primarily for the purchase or construction of vessels to the extent the expenditures increase the operating capacity of or revenue generated by our fleet, while maintenance capital expenditures primarily consist of drydocking expenditures and expenditures to replace vessels in order to maintain the operating capacity of or revenue generated by our fleet. Investment capital expenditures are those capital expenditures that are neither maintenance capital expenditures nor expansion capital expenditures.

We believe that our existing cash and cash equivalents and undrawn long-term borrowings, in addition to all other sources of cash including cash from operations, will be sufficient to meet our existing liquidity needs for at least the next 12 months. Generally, our long-term sources of funds are from cash from operations, long-term bank borrowings and other debt or equity financings, or a combination thereof. Because we and OPCO distribute all of our and its available cash, we expect that we and OPCO will rely upon external financing sources, including bank borrowings and the issuance of debt and equity securities, to fund acquisitions and expansion and investment capital expenditures, including opportunities we may pursue under the omnibus agreement with Teekay Corporation and other of its affiliates.

Cash Flows. The following table summarizes our sources and uses of cash for the periods presented:

	Years Ended December 31,	
	2008 (\$000's)	2007 (\$000's)
Net cash flow from operating activities	122,566	45,847
Net cash flow from (used in) financing activities	38,806	(23,905)
Net cash flow used in investing activities	(151,108)	(14,704)

Operating Cash Flows. Net cash flow from operating activities increased to \$122.6 million for 2008 from \$45.8 million for 2007, primarily due to a net decrease in non-cash working capital, a decrease in distributions from subsidiaries to non-controlling interest owners, and a decrease in drydocking expenditures; partially offset by an increase in vessel operating expenses due to a trend of increasing crew compensation and an increase in interest expense from the increase in debt due to our acquisition of the *SPT Explorer*, the *SPT Navigator*, the *Navion Oslo*, the *Navion Bergen* and the *Dampier Spirit*, and our 50% interest in the *Navion Gothenburg*. Net cash flow from operating activities depends upon the timing and amount of drydocking expenditures, repairs and maintenance activity, vessel additions and dispositions, foreign currency rates, changes in interest rates, fluctuations in working capital balances and spot market hire rates. The number of vessel drydockings tends to be uneven between years.

Financing Cash Flows. Scheduled debt repayments were \$68.0 million during 2008 compared to \$17.3 million during 2007. Net proceeds from long-term debt of \$191.0 million, partially offset by net advances to affiliates of \$46.5 million, were used to finance our acquisition of the *SPT Explorer*, the *SPT Navigator* and the *Navion Oslo*, and to partially fund debt prepayments. The excess of the purchase price over the contributed basis of the *SPT Explorer* and the *SPT Navigator* was \$16.7 million and is reflected as a financing cash flow.

On June 18, 2008, we completed a follow-on public offering of 7.0 million common units at a price of \$20.00 per unit, for gross proceeds of \$140.0 million. Concurrently with the public offering, Teekay Corporation acquired 3.25 million of our common units in a private placement at the same public offering price for \$65.0 million. On July 16, 2008, the underwriters for the public offering partially exercised their over-allotment option and purchased an additional 375,000 common units for an additional \$7.5 million in gross proceeds to us. As a result, we raised gross equity proceeds of \$216.8 million (including our general partner's proportionate 2% capital contribution). The net proceeds were used to fund the purchase of an additional 25% interest in OPCO. The excess of the purchase price over the contributed basis of the 25% additional interest in OPCO was \$91.6 million and is reflected as a financing cash flow.

Cash distributions paid by us during 2008 and 2007 totaled \$42.2 million and \$22.7 million, respectively. Subsequent to December 31, 2008, cash distributions were declared and paid on February 13, 2009 for the three months ended December 31, 2008 and totaled \$13.9 million.

Investing Cash Flows. During 2008, net cash used by investing activities related primarily to the \$115.0 million acquisition from Teekay Corporation of an additional 25% interest in OPCO and \$41.7 million for the acquisition of the *Navion Oslo* from a third party. Additionally, net cash used in investing activities includes expenditures for vessels and equipment of \$16.2 million and \$21.0 million during 2008 and 2007, respectively, for vessels and equipment, and we paid \$0.5 million and \$8.4 million, during 2008 and 2007, respectively, relating to investments in direct financing leases. During 2008 and 2007, we received \$22.4 million and \$21.7 million, respectively, in scheduled repayments from the leasing of our VOC equipment. During 2007 we also received \$3.2 million in proceeds from the sale of certain offshore equipment.

Credit Facilities

As at December 31, 2008, our total debt was \$1.57 billion, compared to \$1.52 billion as at December 31, 2007. As at December 31, 2008, we had seven revolving credit facilities available, which, as at such date, provided for borrowings of up to \$1.46 billion, of which \$142.7 million was undrawn. As at December 31, 2008, five of our six 50% owned subsidiaries had an outstanding term loan, which, in aggregate, totaled \$252.2 million. The joint venture term loans reduce in semi-annual payments with varying maturities through 2017. Please read Item 18 – Financial Statements: Note 6 – Long-Term Debt.

Our seven revolving credit facilities are described in Note 6, Long-Term Debt, to our consolidated financial statements included in this report.

Five of the revolving credit facilities contain covenants that require OPCO to maintain the greater of a minimum liquidity (cash, cash equivalents and undrawn committed revolving credit lines with at least six months of maturity) of \$75.0 million and 5.0% of OPCO's total consolidated debt. The remaining two revolving credit facilities are guaranteed by Teekay Corporation and contain covenants that require Teekay Corporation to maintain the greater of a minimum liquidity of \$50.0 million and 5.0% of Teekay Corporation's total debt, which has recourse to Teekay Corporation. As at

December 31, 2008, we, OPCO and, to our knowledge, Teekay Corporation were in compliance with all of our and its covenants under these credit facilities.

The term loans of our 50% owned subsidiaries are collateralized by first-priority mortgages on the vessels to which the loans relate, together with other related security. As at December 31, 2008, we had guaranteed \$76.0 million of these term loans, which represents our 50% share of the outstanding vessel mortgage debt in five of these 50% owned joint venture companies. Teekay Corporation and our joint venture partner have guaranteed the remaining \$176.2 million.

Interest payments on the revolving credit facilities and term loans are based on LIBOR plus a margin. At December 31, 2008, the margins ranged between 0.45% and 0.95%. At December 31, 2007 the margins ranged between 0.45% and 0.80%.

All of our vessel financings are collateralized by the applicable vessels. The term loans used to finance the five 50% owned joint venture shuttle tankers and our revolving credit facility agreements contain typical covenants and other restrictions, including those that restrict the relevant subsidiaries from:

- incurring or guaranteeing indebtedness (applicable to our term loans and two of our revolving credit facilities);
- changing ownership or structure, including by mergers, consolidations, liquidations and dissolutions;
- making dividends or distributions when in default of the relevant loans;
- making capital expenditures in excess of specified levels;
- making certain negative pledges or granting certain liens;
- selling, transferring, assigning or conveying assets; or
- entering into a new line of business.

We conduct our funding and treasury activities within corporate policies designed to minimize borrowing costs and maximize investment returns while maintaining the safety of the funds and appropriate levels of liquidity for our purposes. We hold cash and cash equivalents primarily in U.S. Dollars.

Contractual Obligations and Contingencies

The following table summarizes our long-term contractual obligations as at December 31, 2008:

	Total	2009	2010 And 2011	2012 and 2013	Beyond 2013
	(in millions of U.S. dollars)				
Long-term debt ⁽¹⁾	1,566.4	125.5	304.0	302.5	834.4
Chartered-in vessels (operating leases)	393.9	109.8	151.5	103.6	29.0
Total contractual obligations	1,960.3	235.3	455.5	406.1	863.4

(1) Excludes expected interest payments of \$51.2 million (2009), \$88.7 million (2010 and 2011), \$68.0 million (2012 and 2013) and \$27.6 million (beyond 2013). Expected interest payments are based on December 31, 2008 LIBOR, plus margins which ranged between 0.45% and 0.95% as at December 31, 2008.

Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements that have or are reasonably likely to have, a current or future material effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

Critical Accounting Estimates

We prepare our consolidated financial statements in accordance with GAAP, which require us to make estimates in the application of our accounting policies based on our best assumptions, judgments and opinions. Management of our general partner reviews our accounting policies, assumptions, estimates and judgments on a regular basis to ensure that our consolidated financial statements are presented fairly and in accordance with GAAP. However, because future events and their effects cannot be determined with certainty, actual results will differ from our assumptions and estimates, and such differences could be material. Accounting estimates and assumptions discussed in this section are those that we consider to be the most critical to an understanding of our financial statements because they inherently involve significant judgments and uncertainties. For a further description of our material accounting policies, please read Item 18 - Financial Statements: Note 1 - Summary of Significant Accounting Policies.

Revenue Recognition

Description. We generate a majority of our revenues from voyages servicing contracts of affreightment, time charters and bareboat charters and, to a lesser extent, spot voyages. Within the shipping industry, the two methods used to account for voyage revenues and expenses are the percentage of completion and the completed voyage methods. Most shipping companies, including us, use the percentage of completion method. For each method, voyages may be calculated on either a load-to-load or discharge-to-discharge basis. In other words, revenues are recognized ratably either from the beginning of when product is loaded for one voyage to when it is loaded for another voyage, or from when product is discharged (unloaded) at the end of one voyage to when it is discharged after the next voyage. We recognize revenues from time charters and bareboat charters daily over the term of the charter as the applicable vessel operates under the charter. We do not recognize revenues during days that a vessel is off-hire.

Judgments and Uncertainties. In applying the percentage of completion method, we believe that in most cases the discharge-to-discharge basis of calculating voyages more accurately reflects voyage results than the load-to-load basis. At the time of cargo discharge, we generally have information about the next load port and expected discharge port, whereas at the time of loading we are normally less certain what the next load port will be. We use this method of revenue recognition for all spot voyages. In the case of our shuttle tankers servicing contracts of affreightment, a voyage commences with tendering of notice of readiness at a field, within the agreed lifting range, and ends with tendering of notice of readiness at a field for the next lifting. In all cases we do not begin recognizing voyage revenue for any of our vessels until a charter has been agreed to by the customer and us, even if the vessel has discharged its cargo and is sailing to the anticipated load port on its next voyage.

Effect if Actual Results Differ from Assumptions. If actual results are not consistent with our estimates in applying the percentage of completion method, our revenues could be overstated or understated for any given period by the amount of such difference.

Vessel Lives and Impairment

Description. The carrying value of each of our vessels represents its original cost at the time of delivery or purchase less depreciation or impairment charges. We depreciate our vessels on a straight-line basis over each vessel's estimated useful life, less an estimated residual value. The carrying values of our vessels may not represent their fair market value at any point in time because the market prices of second-hand vessels tend to fluctuate with changes in charter rates and the cost of newbuildings. Both charter rates and newbuilding costs tend to be cyclical in nature. We review vessels and equipment for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. We measure the recoverability of an asset by comparing its carrying amount to future undiscounted cash flows that the asset is expected to generate over its remaining useful life.

Judgments and Uncertainties. Depreciation is calculated using an estimated useful life of 25 years for our vessels, commencing the date the vessel was originally delivered from the shipyard, or a shorter period if regulations prevent us from operating the vessels for 25 years. In the shipping industry, the use of a 25-year vessel life has become the prevailing standard. However, the actual life of a vessel may be different, with a shorter life resulting in an increase in the quarterly depreciation and potentially resulting in an impairment loss. The estimates and assumptions regarding expected cash flows require considerable judgment and are based upon existing contracts, historical experience, financial forecasts and industry trends and conditions.

Effect if Actual Results Differ from Assumptions. If we consider a vessel or equipment to be impaired, we recognize a loss in an amount equal to the excess of the carrying value of the asset over its fair market value. The new lower cost basis will result in a lower annual depreciation expense than before the vessel impairment.

Drydocking

Description. We drydock each of our shuttle tankers and conventional oil tankers periodically for inspection, repairs and maintenance and for any modifications to comply with industry certification or governmental requirements. We may drydock FSO units if we desire to qualify them for shipping classification. We capitalize a substantial portion of the costs we incur during drydocking and amortize those costs on a straight-line basis from the completion of the drydocking to the estimated completion of the next drydocking. We immediately expense costs for routine repairs and maintenance performed during drydocking that do not improve or extend the useful lives of the assets.

Judgments and Uncertainties. Amortization of capitalized drydock expenditures requires us to estimate the period of the next drydocking. While we typically drydock each shuttle tanker and conventional oil tanker every two and a half to five years, we may drydock the vessels at an earlier date.

Effect if Actual Results Differ from Assumptions. A change in our estimate of the next drydock date will have a direct effect on our annual amortization of drydocking expenditures.

Goodwill and Intangible Assets

Description. We allocate the cost of acquired companies to the identifiable tangible and intangible assets and liabilities acquired, with the remaining amount being classified as goodwill. Certain intangible assets, such as time charters, are amortized over time. Our future operating performance will be affected by the amortization of intangible assets and potential impairment charges related to goodwill. Accordingly, the allocation of purchase price to intangible assets and goodwill may significantly affect our future operating results. Goodwill is not amortized, but reviewed for impairment annually or more frequently if impairment indicators arise.

Judgments and Uncertainties. The allocation of the purchase price of acquired companies to intangible assets and goodwill requires management to make significant estimates and assumptions, including estimates of future cash flows expected to be generated by the acquired assets and the appropriate discount rate to value these cash flows. In addition, the process of evaluating the potential impairment of goodwill and intangible assets is highly subjective and requires significant judgment at many points during the analysis. The fair value of our reporting units was estimated based on discounted expected future cash flows using a weighted-average cost of capital rate. The estimates and assumptions regarding expected cash flows and the appropriate discount rates require considerable judgment and are based upon existing contracts, historical experience, financial forecasts and industry trends and conditions.

Effect if Actual Results Differ from Assumptions. In the fourth quarter of 2008, we completed our annual impairment testing of goodwill using the methodology described above, and determined there was no impairment. If actual results are not consistent with assumptions and estimates, we may be exposed to a goodwill impairment charge. As at December 31, 2008 and 2007, the net book value of goodwill was \$127.1 million.

Amortization expense of intangible assets for 2008 and 2007 was \$10.1 million and \$11.1 million, respectively. If actual results are not consistent with our estimates used to value our intangible assets, we may be exposed to an impairment charge and a decrease in the annual amortization expense of our intangible assets. As at December 31, 2008 and 2007, the net book value of intangible assets was \$45.3 million and \$55.4 million, respectively.

Valuation of Derivative Instruments

Description. Effective January 1, 2008, we adopted Statement of Financial Accounting Standards (or SFAS) No. 157, *Fair Value Measurements*. In accordance with Financial Accounting Standards Board Staff Position No. FAS 157-2, *Effective Date of FASB Statement No. 157*, we deferred the adoption of SFAS No. 157 for our nonfinancial assets and nonfinancial liabilities, except those items recognized or disclosed at fair value on an annual or more frequently recurring basis, until January 1, 2009.

Judgments and Uncertainties. The fair value of our derivative instruments is the estimated amount that we would receive or pay to terminate the agreements in an arm's length transaction under normal business conditions at the reporting date, taking into account current interest rates, foreign exchange rates and the current credit worthiness of ourselves and the counterparties. The estimated amount is the present value of future cash flows. Given the current volatility in the credit markets, it is reasonably possible that the amount recorded as derivative assets and liabilities could vary by a material amount in the near term.

Effect if Actual Results Differ from Assumptions. If our estimates of fair value are inaccurate, this could result in a material adjustment to the carrying amount of derivative asset or liability and consequently the change in fair value for the applicable period that would have been recognized in earnings or other comprehensive income.

Recent Accounting Pronouncements

In April 2009, the Financial Accounting Standards Board (or FASB) issued Statement of Financial Accounting Standards (or SFAS) 115-2 and SFAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*. This statement changes existing accounting requirements for other-than-temporary impairment. SFAS 115-2 is effective for interim and annual periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. We are currently evaluating the potential impact, if any, of the adoption of SFAS 115-2 on our consolidated results of operations and financial condition.

In April 2009, the FASB issued SFAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability has Significantly Decreased and Identifying Transactions that are Not Orderly*. SFAS 157-4 amends SFAS 157, *Fair Value Measurements* to provide additional guidance on estimating fair value when the volume and level of transaction activity for an asset or liability have significantly decreased in relation to normal market activity for the asset or liability. SFAS 157-4 also provides additional guidance on circumstances that may indicate that a transaction is not orderly. SFAS 157-4 supersedes SFAS 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active*. The guidance in SFAS 157-4 is effective for interim and annual reporting periods ending after June 15, 2009. Early adoption is permitted, but only for periods ending after March 15, 2009. We are currently evaluating the potential impact, if any, of the adoption of SFAS 157-4 on our consolidated results of operations and financial condition.

In April 2009, the FASB issued SFAS 107-1 and APB 28-1, *Interim Disclosures About Fair Value of Financial Instruments*. SFAS 107-1 extends the disclosure requirements of SFAS 107, *Disclosures about Fair Value of Financial Instruments* to interim financial statements of publicly traded companies as defined in APB Opinion No. 28, *Interim Financial Reporting*. SFAS 107-1 is effective for interim reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. We are currently evaluating the potential impact, if any, of the adoption of SFAS 107-1 on our consolidated results of operations and financial condition.

In April 2009, the FASB issued SFAS 141(R)-1, *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination that Arise from Contingencies*. This statement amends SFAS 141, *Business Combinations*, to require that assets acquired and liabilities assumed in a business combination that arise from contingencies be recognized at fair value, in accordance with SFAS 157, if the fair value can be determined during the measurement period. SFAS 141(R)-1 is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. We are currently evaluating the potential impact, if any, of the adoption of SFAS 141(R)-1 on our consolidated results of operations and financial condition.

In October 2008, the FASB issued SFAS No. 157-3, *Determining the Fair Value of a Financial Asset in a Market That Is Not Active*, which clarifies the application of SFAS 157 when the market for a financial asset is inactive. Specifically, SFAS No. 157-3 clarifies how (1) management's internal assumptions should be considered in measuring fair value when observable data are not present, (2) observable market information from an inactive market should be taken into account, and (3) the use of broker quotes or pricing services should be considered in assessing the relevance of observable and unobservable data to measure fair value. The guidance in SFAS No. 157-3 is effective immediately but does not have any impact on our consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities, an amendment of Statement of Financial Accounting Standards No. 133 (or SFAS 161)*. The statement requires qualitative disclosures about an entity's objectives and strategies for using derivatives and quantitative disclosures about how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows. SFAS 161 is effective for fiscal years, and interim periods within those fiscal years, beginning after November 15, 2008, with early application allowed. SFAS 161 allows but does not require, comparative disclosures for earlier periods at initial adoption.

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations (or SFAS 141(R))*, which replaces SFAS No. 141, *Business Combinations*. This statement establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired. SFAS 141(R) also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS 141(R) is effective for fiscal years beginning after December 15, 2008. We are currently evaluating the potential impact, if any, of the adoption of SFAS 141(R) on our consolidated results of operations and financial condition.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements, an Amendment of Accounting Research Bulletin No. 51 (or SFAS 160)*. This statement establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent's ownership interest, and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. SFAS 160 also establishes disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS 160 is effective for fiscal years beginning after December 15, 2008. We are currently evaluating the potential impact, if any, of the adoption of SFAS 160 on our consolidated results of operations and financial condition.

Item 6. Directors, Senior Management and Employees

A. Directors and Senior Management

Management of Teekay Offshore Partners L.P.

Teekay Offshore GP L.L.C., our general partner, manages our operations and activities. Unitholders are not entitled to elect the directors of our general partner or directly or indirectly participate in our management or operation.

Our general partner owes a fiduciary duty to our unitholders. Our general partner is liable, as general partner, for all of our debts (to the extent not paid from our assets), except for indebtedness or other obligations that are expressly non-recourse to it. Whenever possible, our general partner intends to cause us to incur indebtedness or other obligations that are non-recourse to it.

The directors of our general partner oversee our operations. The day-to-day affairs of our business are managed by the officers of our general partner and key employees of certain of our controlled affiliates, including OPCO. Employees of certain subsidiaries of Teekay Corporation provide assistance to us and OPCO pursuant to services agreements. Please see Item 7- Major Unitholders and Related Party transactions.

The Chief Executive Officer and Chief Financial Officer of our general partner, Peter Evensen, allocates his time between managing our business and affairs and the business and affairs of Teekay Corporation and its subsidiaries Teekay LNG Partners L.P. (NYSE: TGP) (or *Teekay LNG*) and Teekay Tankers Ltd. (NYSE: TNK) (or *Teekay Tankers*). Mr. Evensen is the Executive Vice President and Chief Strategy Officer of Teekay Corporation, and the Chief Executive Officer and Chief Financial Officer of Teekay LNG's general partner, and the Executive Vice President of Teekay Tankers. The amount of time Mr. Evensen allocates among our business and the businesses of Teekay Corporation, Teekay LNG and Teekay Tankers varies from time to time depending on various circumstances and needs of the businesses, such as the relative levels of strategic activities of the businesses. We believe Mr. Evensen devotes sufficient time to our business and affairs as is necessary for their proper conduct.

Teekay Offshore Operating GP L.L.C., the general partner of OPCO, manages OPCO's operations and activities. The Board of Directors of Teekay Offshore GP L.L.C., our general partner, has the authority to appoint and elect the directors of Teekay Offshore Operating GP L.L.C., who in turn appoint the officers of Teekay Offshore Operating GP L.L.C. Some of the directors and officers of our general partner also serve as directors or executive officers of OPCO's general partner. Any amendment to OPCO's partnership agreement or to the limited liability company agreement of OPCO's general partner must be approved by the conflicts committee of the Board of Directors of our general partner, Teekay Offshore GP L.L.C. Other actions affecting OPCO, including, among other things, the amount of its cash reserves, must be approved by our general partner's Board of Directors on our behalf.

Officers of our general partner and those individuals providing services to us, OPCO or our other subsidiaries may face a conflict regarding the allocation of their time between our business and the other business interests of Teekay Corporation or its other affiliates. Our general partner intends to seek to cause its officers to devote as much time to the management of our business and affairs as is necessary for the proper conduct of our business and affairs.

Directors and Executive Officers of Teekay Offshore GP L.L.C.

The following table provides information about the directors and executive officers of our general partner, Teekay Offshore GP L.L.C. Directors are elected for one-year terms. The business address of each of our directors and executive officers listed below is c/o 4th Floor, Belvedere Building, 69 Pitts Bay Road, Hamilton, HM 08, Bermuda. Ages of the directors are as of December 31, 2008.

<u>Name</u>	<u>Age</u>	<u>Position</u>
C. Sean Day	59	Chairman ⁽¹⁾
Bjorn Moller	51	Vice Chairman ⁽¹⁾
Peter Evensen	50	Chief Executive Officer, Chief Financial Officer and Director
David L. Lemmon	66	Director ⁽²⁾
Carl Mikael L.L. von Mentzer	64	Director ⁽²⁾
John J. Peacock	65	Director ⁽²⁾

(1) Member of Corporate Governance Committee

(2) Member of Audit Committee and Conflicts Committee

Certain biographical information about each of these individuals is set forth below.

C. Sean Day has served as Chairman of Teekay Offshore GP L.L.C. and of Teekay Offshore Operating GP L.L.C. since they were formed in August and September 2006, respectively. Mr. Day has served as Chairman of Teekay Corporation's Board of Directors since 1999. From 1989 to 1999, he was President and Chief Executive Officer of Navios Corporation, a large bulk shipping company based in Stamford, Connecticut. Prior to Navios, Mr. Day held a number of senior management positions in the shipping and finance industries. Mr. Day has served as the Chairman of Teekay GP L.L.C., the general partner of Teekay LNG, and of Teekay Tankers since they were formed in November 2004 and October 2007, respectively. Mr. Day also serves as the Chairman of Compass Diversified Trust and as a director of Kirby Corporation.

Bjorn Moller has served as the Vice Chairman of Teekay Offshore GP L.L.C. and of Teekay Offshore Operating GP L.L.C. since they were formed in August and September 2006, respectively. Mr. Moller is the President and Chief Executive Officer of Teekay Corporation and has held those positions since April 1998. Mr. Moller has over 25 years' experience in the shipping industry and has served in senior management positions with Teekay Corporation for more than 15 years. He has headed its overall operations since January 1997, following his promotion to the position of Chief Operating Officer. Prior to this, Mr. Moller headed Teekay Corporation's global chartering operations and business development activities. Mr. Moller has also served as the Vice Chairman of Teekay GP L.L.C. and as the Chief Executive Officer and as a director of Teekay Tankers since

they were formed in November 2004 and October 2007, respectively. Mr Moller has served as Chairman of the International Tanker Owners Pollution Federation since 2006 and on the Board of the American Petroleum Institute since 2000.

Peter Evensen has served as the Chief Executive Officer and Chief Financial Officer and as a Director of Teekay Offshore GP L.L.C. and of Teekay Offshore Operating GP L.L.C. since they were formed in August and September 2006, respectively. Mr. Evensen is also the Executive Vice President and Chief Strategy Officer of Teekay Corporation. He joined Teekay Corporation in May 2003 as Senior Vice President, Treasurer and Chief Financial Officer. He served as Executive Vice President and Chief Financial Officer of Teekay Corporation from February 2004 until he was appointed to his current role in November 2006. Mr. Evensen has also served as Chief Executive Officer and Chief Financial Officer of Teekay GP L.L.C. since it was formed in November 2004, as a director of Teekay GP L.L.C. since January 2005, and as the Executive Vice President and as a Director of Teekay Tankers since it was formed in October 2007. Mr. Evensen has over 25 years' experience in banking and shipping finance. Prior to joining Teekay Corporation, Mr. Evensen was Managing Director and Head of Global Shipping at J.P. Morgan Securities Inc. and worked in other senior positions for its predecessor firms. His international industry experience includes positions in New York, London and Oslo.

David L. Lemmon has served as a Director of Teekay Offshore GP L.L.C. since December 2006. Mr. Lemmon currently serves on the Board of Directors of Kirby Corporation and Deltic Timber Corporation, positions he has held since April 2006 and February 2007, respectively. He also served on the Board of Directors of Pacific Energy Partners, L.P. from 2002 through 2006. Mr. Lemmon was President and Chief Executive Officer of Colonial Pipeline Company from 1997 until his retirement from that company in March 2006. Prior to joining Colonial Pipeline Company, he served as President of Amoco Pipeline Company.

Carl Mikael L.L. von Mentzer has served as a Director of Teekay Offshore GP L.L.C. since December 2006. Mr. von Mentzer has over 30 years' experience in the shipbuilding, shipping, and offshore oil industries. Since 1998, Mr. von Mentzer has served as a non-executive director of Concordia Maritime AB in Gothenburg, Sweden and since 2002 has served as its Deputy Chairman of its Board of Directors. Prior to this, Mr. von Mentzer served in executive positions with various shipping and offshore oil companies, including Gotaverken Ardenal AB and Safe Partners AB in Gothenburg, Sweden and OAG Ltd. in Aberdeen, Scotland. He has also previously served as a director for Northern Offshore Ltd., in Oslo, Norway, and GVA Consultants in Gothenburg, Sweden.

John J. Peacock has served as a Director of Teekay Offshore GP L.L.C. since December 2006. Mr. Peacock is currently a director of the Fednav Group of companies, a Canadian ocean-going dry-bulk shipowning and chartering group. He was the President, Chief Operating Officer, Executive Vice-President and director of Fednav Limited from 1998 until February 2007. Mr. Peacock joined Fednav Limited in 1979 as its Treasurer, and in 1984 became Vice President, Finance. He has over 40 years' accounting experience. Prior to joining the Fednav Group, Mr. Peacock was a partner with Clarkson Gordon (now Ernst & Young) in Montreal, Canada.

Directors and Executive Officers of Teekay Offshore Operating GP L.L.C.

The following table provides information about the directors and executive officers of Teekay Offshore Operating GP L.L.C., the general partner of OPCO. Directors are appointed for one-year terms. The business address of each director and executive officer of Teekay Offshore Operating GP L.L.C. listed below is c/o 4th Floor, Belvedere Building, 69 Pitts Bay Road, Hamilton, HM 08, Bermuda. Ages of the directors are as of December 31, 2008.

<u>Name</u>	<u>Age</u>	<u>Position</u>
C. Sean Day	59	Chairman
Bjorn Moller	51	Vice Chairman
Peter Evensen	50	Chief Executive Officer, Chief Financial Officer and Director

As described above, the directors and executive officers of Teekay Offshore Operating GP L.L.C. also serve as directors or executive officers of Teekay Offshore GP L.L.C. The business experience of these individuals is included above.

B. Compensation

Reimbursement of Expenses of Our General Partner

Our general partner does not receive any management fee or other compensation for managing us. Our general partner and its other affiliates are reimbursed for expenses incurred on our behalf. These expenses include all expenses necessary or appropriate for the conduct of our business and allocable to us, as determined by our general partner. During 2008, we reimbursed our general partner for \$0.6 million (\$0.8 million – 2007) in expenses that it incurred on our behalf during the year. Our general partner did not incur any of such expenses during 2006.

Executive Compensation

We and our general partner were formed in August 2006. OPCO's general partner was formed in September 2006. Neither our general partner nor OPCO's general partner paid any compensation to its directors or officers or accrued any obligations with respect to management incentive or retirement benefits for the directors and officers prior to our initial public offering in December 2006. Because Peter Evensen, the Chief Executive Officer and Chief Financial Officer of our general partner and of OPCO's general partner, is an employee of a subsidiary of Teekay Corporation, his compensation (other than any awards under the long-term incentive plan described below) is set and paid by the Teekay Corporation subsidiary, and we reimburse the Teekay Corporation subsidiary for time he spends on our partnership matters. Please read Item 7. Major Unitholders and Related Party Transactions.

Compensation of Directors

Officers of our general partner or Teekay Corporation who also serve as directors of our general partner or OPCO's general partner do not receive additional compensation for their service as directors. During 2008, each non-management director received compensation for attending meetings of the Board of Directors, as well as committee meetings. Each non-management director received a director fee of \$40,000 for the year and common units with a value of approximately \$30,000 for the year. The Chairman received an annual fee of \$65,000 and common units with a value of approximately \$65,000 for the year. Members of the audit and conflicts committees, and members and the chair of the governance committees each received a committee fee of \$5,000 for the year, and the chairs of the audit committee and conflicts committee received an additional fee of

\$10,000 for the year for serving in that role. In addition, each director was reimbursed for out-of-pocket expenses in connection with attending meetings of the Board of Directors or committees. Each director is fully indemnified by us for actions associated with being a director to the extent permitted under Marshall Islands law.

During 2008, the four non-employee directors received, in the aggregate, \$389,000 in director and committee fees and reimbursement of \$89,801 of their out-of-pocket expenses from us relating to their board service. We reimbursed our general partner for these expenses as they were incurred for the conduct of our business. In March 2008, our general partner's Board of Directors granted to the four non-employee directors 4,041 units at \$23.51 per unit. During March 2009, the Board authorized the award by us to the four non-employee directors of common units with a value of approximately \$155,000 for the 2009 year.

2006 Long-Term Incentive Plan

Our general partner adopted the Teekay Offshore Partners L.P. 2006 Long-Term Incentive Plan for employees and directors of and consultants to our general partner and employees and directors of and consultants to its affiliates, who perform services for us. The plan provides for the award of restricted units, phantom units, unit options, unit appreciation rights and other unit or cash-based awards. Other than the previously mentioned common units awarded to our general partner's non-employee directors, we did not make any awards in 2008 under the 2006 Long-Term Incentive Plan.

C. Board Practices

Teekay Offshore GP L.L.C., our general partner, manages our operations and activities. Unitholders are not entitled to elect the directors of our general partner or directly or indirectly participate in our management or operation.

Our general partner's Board of Directors (or *the Board*) currently consists of six members. Directors are appointed to serve until their successors are appointed or until they resign or are removed.

There are no service contracts between us and any of our directors providing for benefits upon termination of their employment or service.

The Board has the following three committees: Audit Committee, Conflicts Committee, and Corporate Governance Committee. The membership of these committees and the function of each of the committees are described below. Each of the committees is currently comprised solely of independent members, except for the Corporate Governance Committee, and operates under a written charter adopted by the Board, other than the Conflicts Committee. The committee charters for the Audit Committee, the Conflicts Committee and the Corporate Governance Committee are available under "Other Information--Partnership Governance" in the Investor Centre of our web site at www.teekayoffshore.com. During 2008, the Board held five meetings. Each director attended all Board meetings and all applicable committee meetings.

Audit Committee. The Audit Committee of our general partner is composed of three or more directors, each of whom must meet the independence standards of the NYSE, the SEC and any other applicable laws and regulations governing independence from time to time. This committee is currently comprised of directors John J. Peacock (Chair), David L. Lemmon and Carl Mikael L.L. von Mentzer. All members of the committee are financially literate and the Board has determined that Mr. Lemmon qualifies as an audit committee financial expert.

The Audit Committee assists the Board in fulfilling its responsibilities for general oversight of:

- the integrity of our financial statements;
- our compliance with legal and regulatory requirements;
- the qualifications and independence of our independent auditor; and
- the performance of our internal audit function and our independent auditor.

Conflicts Committee. The Conflicts Committee of our general partner is composed of the same directors constituting the Audit Committee, being David L. Lemmon (Chair), John J. Peacock, and Carl Mikael L.L. von Mentzer. The members of the Conflicts Committee may not be officers or employees of our general partner or directors, officers or employees of its affiliates, and must meet the heightened NYSE and SEC director independence standards applicable to audit committee membership and certain other requirements.

The Conflicts Committee:

- reviews specific matters that the Board believes may involve conflicts of interest; and
- determines if the resolution of the conflict of interest is fair and reasonable to us.

Any matters approved by the Conflicts Committee will be conclusively deemed to be fair and reasonable to us, approved by all of our partners, and not a breach by our general partner of any duties it may owe us or our unitholders. The Board is not obligated to seek approval of the Conflicts Committee on any matter, and may determine the resolution of any conflict of interest itself.

Corporate Governance Committee. The Corporate Governance Committee of our general partner is composed of at least two directors. This committee is currently comprised of directors C. Sean Day (Chair) and Bjorn Moller.

The Corporate Governance Committee:

- oversees the operation and effectiveness of the Board and its corporate governance.

- develops, updates and recommends to the Board corporate governance principles and policies applicable to us and our general partner and monitors compliance with these principles and policies; and
- oversees director compensation and the long-term incentive plan described above.

D. Employees

Crewing and Staff

As of December 31, 2008, approximately 1,420 seagoing staff served on our vessels and approximately 160 staff served on shore in technical, commercial and administrative roles in various countries. Certain subsidiaries of Teekay Corporation employ the crews, who serve on the vessels pursuant to agreements with the subsidiaries, and Teekay Corporation subsidiaries also provide on-shore advisory, operational and administrative support to our operating subsidiaries pursuant to service agreements. Please see Item 7- Major Unitholders and Related Party transactions.

Teekay Corporation regards attracting and retaining motivated seagoing personnel as a top priority, and offers seafarers what we believe are highly competitive employment packages and comprehensive benefits and opportunities for personal and career development, which relates to a philosophy of promoting internally.

Teekay Corporation has entered into a Collective Bargaining Agreement with the Philippine Seafarers' Union, an affiliate of the International Transport Workers' Federation (or *ITF*), and a Special Agreement with ITF London, which covers substantially all of the officers and seamen that operate our and OPCO's Bahamian-flagged vessels. Substantially all officers and seamen for the Norway-flagged vessels are covered by a collective bargaining agreement with Norwegian unions (Norwegian Maritime Officers' Association, Norwegian Union of Marine Engineers and the Norwegian Seafarers' Union). We believe Teekay Corporation's relationships with these labor unions are good.

Our commitment to training is fundamental to the development of the highest caliber of seafarers for marine operations. Teekay Corporation's cadet training approach is designed to balance academic learning with hands-on training at sea. Teekay Corporation has relationships with training institutions in Canada, Croatia, India, Norway, Philippines, Turkey and the United Kingdom. After receiving formal instruction at one of these institutions, cadet training continues on board vessels. Teekay Corporation also has a career development plan that was devised to ensure a continuous flow of qualified officers who are trained on its vessels and familiarized with its operational standards, systems and policies. We believe that high-quality crewing and training policies will play an increasingly important role in distinguishing larger independent shipping companies that have in-house or affiliate capabilities from smaller companies that must rely on outside ship managers and crewing agents on the basis of customer service and safety.

E. Unit Ownership

The following table sets forth certain information regarding beneficial ownership, as of June 1, 2009, of our units by all directors and officers of our general partner as a group. The information is not necessarily indicative of beneficial ownership for any other purpose. Under SEC rules a person beneficially owns any units that the person has the right to acquire as of July 31, 2009 (60 days after June 1, 2009) through the exercise of any unit option or other right. Unless otherwise indicated, each person has sole voting and investment power (or shares such powers with his or her spouse) with respect to the units set forth in the following table. Information for all persons listed below is based on information delivered to us.

<u>Identity of Person or Group</u>	<u>Common Units Owned</u>	<u>Percentage of Common Units Owned</u>	<u>Subordinated Units Owned</u>	<u>Percentage of Subordinated Units Owned</u>	<u>Percentage of Total Common and Subordinated Units Owned</u> ⁽³⁾
All directors and officers as a group (6 persons) ⁽¹⁾⁽²⁾	314,999	1.54%	-	-	1.04%

(1) Excludes units owned by Teekay Corporation, which controls us and on the board of which serve the directors of our general partner, C. Sean Day and Bjorn Moller. In addition, Mr. Moller is Teekay Corporation's President and Chief Executive Officer, and Peter Evensen, our general partner's Chief Executive Officer and Chief Financial Officer and a Director, is Teekay Corporation's Executive Vice President and Chief Strategy Officer. Please read Item 7: Major Shareholders and Related Party Transactions for more detail.

(2) Each director, executive officer and key employee beneficially owns less than one percent of the outstanding common and subordinated units.

(3) Excludes the 2% general partner interest held by our general partner, a wholly owned subsidiary of Teekay Corporation.

Item 7. Major Unitholders and Related Party Transactions

A. Major Unitholders

The following table sets forth the beneficial ownership, as of June 1, 2009, of our common and subordinated units by each person we know to beneficially own more than 5% of the outstanding common or subordinated units. The number of units beneficially owned by each person is determined under SEC rules and the information is not necessarily indicative of beneficial ownership for any other purpose. Under SEC rules a person beneficially owns any units as to which the person has or shares voting or investment power. In addition, a person beneficially owns any units that the person or entity has the right to acquire as of July 31, 2009 (60 days after June 1, 2009) through the exercise of any unit option or other right. Unless otherwise indicated, each unitholder listed below has sole voting and investment power with respect to the units set forth in the following table.

Identity of Person or Group

	<u>Common Units Owned</u>	<u>Percentage of Common Units Owned</u>	<u>Subordinated Units Owned</u>	<u>Percentage of Subordinated Units Owned</u>	<u>Percentage of Total Common and Subordinated Units Owned</u>
Teekay Corporation ⁽¹⁾	5,000,000	24.5%	9,800,000	100.0%	49.0%
Kayne Anderson Capital Advisors, LP, and Richard A. Kayne, as a group ⁽²⁾	1,388,216	6.8%	-	-	4.6%
Neuberger Berman, Inc. and Neuberger Berman, LLC, as a group ⁽³⁾	1,360,560	6.7%	-	-	4.5%
Luxor Capital Group, LP, Luxor Management, LLC, and Mr. Christian Leone, as a group ⁽⁴⁾	1,289,479	6.3%	-	-	4.3%

- (1) Excludes the 2% general partner interest held by our general partner, a wholly owned subsidiary of Teekay Corporation.
- (2) Includes shared voting power and shared dispositive power as to 1,388,216 units. Kayne Anderson Capital Advisors, LP, and Richard A. Kayne both have shared voting and dispositive power. Kayne Anderson Capital Advisors, LP serves as an investment adviser of Kayne Anderson Capital Advisor, LP's mutual funds. This information is based on the Schedule 13G/A filed by this group with the SEC on February 11, 2009.
- (3) Includes sole voting power as to 1,278,860 units and shared dispositive power as to 1,360,560 units. Both Neuberger Berman, LLC and Neuberger Berman Inc. have shared dispositive power. Neuberger Berman, LLC and Neuberger Berman Management Inc. serve as sub-advisor and investment manager, respectively, of Neuberger Berman Inc.'s mutual funds. This information is based on the Schedule 13G filed by this group with the SEC on February 12, 2009.
- (4) Includes shared voting power and shared dispositive power as to 1,289,479 units. Luxor Capital Group, LP, Luxor Management, LLC, and Mr. Christian Leone all have shared voting and dispositive power. Luxor Capital Group, LP serves as an investment manager of Luxor Capital Group, LP's mutual funds. This information is based on the Schedule 13G/A filed by this group with the SEC on February 17, 2009.

We are controlled by Teekay Corporation. We are not aware of any arrangements, the operation of which may at a subsequent date result in a change in control of us.

B. Related Party Transactions

- a) On October 1, 2006, OPCO entered into time-charter contracts for its nine Aframax conventional tankers with a subsidiary of Teekay Corporation at then-prevailing market-based daily rates for terms of five to twelve years. Under the terms of eight of these nine time-charter contracts, OPCO is responsible for the bunker fuel expenses; however, OPCO adds the approximate amounts of these expenses to the daily hire rate. Pursuant to these time-charter contracts, OPCO earned voyage revenues of \$144.5 million during 2008.
- b) Effective October 1, 2006, two of OPCO's shuttle tankers commenced employment on long-term bareboat charters with a subsidiary of Teekay Corporation. Pursuant to these charter contracts, OPCO earned voyage revenues of \$14.8 million during 2008.
- c) During 2008, two of OPCO's FSO units were employed on long-term bareboat charters with a subsidiary of Teekay Corporation. Pursuant to these charter contracts, OPCO earned voyage revenues of \$11.2 million during 2008.
- d) On October 1, 2006, a subsidiary of Teekay Corporation entered into a services agreement with a subsidiary of OPCO, pursuant to which the subsidiary of OPCO provides the Teekay Corporation subsidiary with ship management services. During 2008, OPCO earned management fees of \$3.3 million under the agreement.
- e) Eight of OPCO'S Aframax conventional oil tankers and three FSO units are managed by subsidiaries of Teekay Corporation. Pursuant to the associated management services agreements, OPCO incurred general and administrative expenses of \$3.7 million during 2008.
- f) In December 2006, we, OPCO, and certain of our and its subsidiaries entered into services agreements with certain subsidiaries of Teekay Corporation, pursuant to which the Teekay Corporation subsidiaries provide to us, OPCO, and our and its subsidiaries administrative, advisory and technical services and ship management. These services are provided in a commercially reasonable manner and upon the reasonable request of our general partner or our or OPCO's operating subsidiaries, as applicable. The Teekay Corporation subsidiaries that are parties to the services agreements provide these services directly or subcontract for certain of these services with other entities, including other Teekay Corporation subsidiaries. We pay arm's-length fees for the services that include reimbursement of the reasonable cost of any direct and indirect expenses the Teekay Corporation subsidiaries incur in providing these services. During 2008, we incurred \$50.3 million of costs under these agreements.
- g) Pursuant to our partnership agreement, we reimburse our general partner for all expenses necessary or appropriate for the conduct of our business. During 2008, we incurred \$0.6 million of these costs.
- h) In July 2007, we acquired interests in two double-hull shuttle tankers from Teekay Corporation for a total cost of \$159.1 million, including assumption of debt of \$93.7 million and the related interest rate swap agreement. We acquired Teekay Corporation's 100% interest in the 2000-built *Navion Bergen* and its 50% interest in the 2006-built *Navion Gothenburg*, together with their respective 13-year, fixed-rate bareboat charters to Petroleo Brasileiro S.A. We financed the purchases with one of our existing revolving credit facilities and the assumption of debt. The excess of the proceeds we paid over Teekay Corporation's historical cost were accounted for as an equity distribution to Teekay Corporation of \$25.4 million.

- i) In October 2007, we acquired from Teekay Corporation an FSO unit, the *Dampier Spirit*, along with its 7-year fixed-rate time-charter to Apache Corporation for a total cost of \$30.3 million. We financed the purchase with one of our existing revolving credit facilities. The excess of the proceeds we paid over Teekay Corporation's historical cost was accounted for as an equity distribution to Teekay Corporation of \$13.9 million.
- j) In December 2007, Teekay Corporation contributed a \$65.6 million, nine-year, 4.98% interest rate swap agreement (used to hedge the debt assumed in the purchase of the *Navion Bergen*) having a fair value liability of \$2.6 million, to us for no consideration and was accounted for as an equity distribution to Teekay Corporation.
- k) In December 2007, Teekay Corporation agreed to reimburse OPCO for certain costs relating to events which occurred prior to our initial public offering, totaling \$4.8 million, including the settlement of a customer dispute in respect of vessels delivered prior to our initial public offering and other costs.
- l) C. Sean Day is the Chairman of our general partner, Teekay Offshore GP L.L.C., and of Teekay Offshore Operating GP L.L.C., the general partner of OPCO. He also is the Chairman of Teekay Corporation, Teekay Tankers and Teekay GP L.L.C., the general partner of Teekay LNG.

Bjorn Moller is the Vice Chairman of Teekay Offshore GP L.L.C., Teekay Offshore Operating GP L.L.C. and Teekay GP L.L.C. He also is the President and Chief Executive Officer and a director of Teekay Corporation and the Chief Executive Officer and a director of Teekay Tankers.

Peter Evensen is the Chief Executive Officer and Chief Financial Officer and a director of Teekay Offshore GP L.L.C., Teekay Offshore Operating GP L.L.C. and Teekay GP L.L.C. He also is the Executive Vice President and Chief Strategy Officer of Teekay Corporation and the Executive Vice President and a director of Teekay Tankers.

Because Mr. Evensen is an employee of a subsidiary of Teekay Corporation, his compensation (other than any awards under the long-term incentive plan) is set and paid by the Teekay Corporation subsidiary. Pursuant to our partnership agreement, we have agreed to reimburse the Teekay Corporation subsidiary for time spent by Mr. Evensen on our management matters as our Chief Executive Officer and Chief Financial Officer.

- m) We have entered into an amended and restated omnibus agreement with our general partner, Teekay Corporation, Teekay LNG and related parties. The following discussion describes certain provisions of the omnibus agreement.

Noncompetition. Under the omnibus agreement, Teekay Corporation and Teekay LNG have agreed, and have caused their controlled affiliates (other than us) to agree, not to own, operate or charter "offshore vessels" (i.e. dynamically positioned shuttle tankers (other than those operating in the conventional oil tanker trade under contracts with a remaining duration of less than three years, excluding extension options), FSOs and FPSOs). This restriction does not prevent Teekay Corporation, Teekay LNG or any of their other controlled affiliates from, among other things:

- owning, operating or chartering offshore vessels if the remaining duration of the time charter or contract of affreightment for the vessel, excluding any extension options, is less than three years;
- acquiring offshore vessels and related time charters or contracts of affreightment as part of a business or package of assets and operating or chartering those vessels if a majority of the value of the total assets or business acquired is not attributable to the offshore vessels and related contracts, as determined in good faith by the board of directors of Teekay Corporation or the conflicts committee of the board of directors of Teekay LNG's general partner; however, if Teekay Corporation or Teekay LNG completes such an acquisition, it must, within one year after completing the acquisition, offer to sell the offshore vessels and related contracts to us for their fair market value plus any additional tax or other similar costs to Teekay Corporation or Teekay LNG that would be required to transfer the offshore vessels and contracts to us separately from the acquired business or package of assets;
- owning, operating or chartering offshore vessels and related time charters and contracts of affreightment that relate to a tender, bid or award for a proposed offshore project that Teekay Corporation or any of its subsidiaries has submitted or hereafter submits or receives; however, at least one year after the delivery date of any such offshore vessel, Teekay Corporation must offer to sell the offshore vessel and related contract to us, with the vessel valued (i) for newbuildings originally contracted by Teekay Corporation, at its "fully-built-up cost" (which represents the aggregate expenditures incurred (or to be incurred prior to delivery to us) by Teekay Corporation to acquire, construct, and/or convert and bring such offshore vessel to the condition and location necessary for our intended use, plus project development costs for completed projects and projects that were not completed but, if completed, would have been subject to an offer to us pursuant to the omnibus agreement) and (ii) for any other vessels, Teekay Corporation's cost to acquire a newbuilding from a third party or the fair market value of any existing vessel, as applicable, plus in each case any subsequent expenditures that would be included in the "fully-built-up cost" of converting the vessel prior to delivery to us;
- acquiring, operating or chartering offshore vessels if our general partner has previously advised Teekay Corporation or Teekay LNG that the board of directors of our general partner has elected, with the approval of its conflicts committee, not to cause us or our subsidiaries to acquire or operate the vessels; or
- owning a limited partner interest in OPCO or owning shares of Teekay Petrojarl ASA (*Teekay Petrojarl*).

In addition, under the omnibus agreement we have agreed not to own, operate or charter crude oil tankers or liquefied natural gas (or LNG) carriers. This restriction does not apply to any of the Aframax tankers in our current fleet, and the ownership, operation or chartering of any oil tankers that replace any of those oil tankers in connection with certain events. In addition, the restriction does not prevent us from, among other things:

- acquiring oil tankers or LNG carriers and any related time charters as part of a business or package of assets and operating or chartering those vessels, if a majority of the value of the total assets or business acquired is not attributable to the oil tankers and LNG carriers and any related charters, as determined in good faith by the conflicts committee of our general partner's board of

directors; however, if at any time we complete such an acquisition, we are required to promptly offer to sell to Teekay Corporation the oil tankers and time charters or to Teekay LNG the LNG carriers and time charters for fair market value plus any additional tax or other similar costs to us that would be required to transfer the vessels and contracts to Teekay Corporation or Teekay LNG separately from the acquired business or package of assets; or

- acquiring, operating or chartering oil tankers or LNG carriers if Teekay Corporation or Teekay LNG, respectively, has previously advised our general partner that it has elected not to acquire or operate those vessels.

Rights of First Offer on Conventional Tankers, LNG Carriers and Offshore Vessels. Under the omnibus agreement, we have granted to Teekay Corporation and Teekay LNG a 30-day right of first offer on certain (a) sales, transfers or other dispositions of any of our Aframax tankers, in the case of Teekay Corporation, or certain LNG carriers in the case of Teekay LNG, or (b) re-charterings of any of our Aframax tankers or LNG carriers pursuant to a time charter or contract of affreightment with a term of at least three years if the existing charter expires or is terminated early. Likewise, each of Teekay Corporation and Teekay LNG has granted a similar right of first offer to us for any offshore vessels it might own that, at the time of the proposed offer, is subject to a time charter or contract of affreightment with a remaining term, excluding extension options, of at least three years. These rights of first offer do not apply to certain transactions. On December 4, 2008, Teekay Petrojarl re-chartered the FPSO unit, the *Varg*, for a period exceeding three years. We agreed to waive Teekay Corporation's obligation to offer the unit to us for charter or purchase within 30 days of the re-chartering in exchange for the right to acquire the unit, for its fair market value, at any time until December 4, 2009.

The omnibus agreement also obligated Teekay Corporation to offer to us prior to July 9, 2009, existing FPSO units of Teekay Petrojarl that were servicing contracts in excess of three years in length as of July 9, 2008, the date on which Teekay Corporation acquired 100% of Teekay Petrojarl. We have agreed to waive Teekay Corporation's obligation to offer these FPSO units to us by July 9, 2009 in exchange for the right to acquire these units, for their fair market value, at any time until July 9, 2010. The purchase price for any such existing FPSO units of Teekay Petrojarl would be their fair market value plus any additional tax or other similar costs to Teekay Petrojarl that would be required to transfer the offshore vessels to us.

- (n) In January 2007, Teekay Corporation contributed foreign exchange contracts for the forward purchase of a total of Australian Dollars 4.5 million having a fair value asset of \$0.1 million, net of non-controlling interest, to OPCO for no consideration and was accounted for as an equity contribution from Teekay Corporation. The foreign currency forward contracts matured by December 2007.
- (o) During 2007, \$1.2 million of interest expense attributable to the operations of the *Navion Bergen* was incurred by Teekay Corporation and has been allocated to us as part of the results of the Dropdown Predecessor.
- (p) In March 2008, Teekay Corporation agreed to reimburse us for repair costs relating to one of our shuttle tankers. The vessel was purchased from Teekay Corporation in July 2007 and had, as of the date of acquisition, an inherent minor defect that required repairs. Pursuant to this agreement, Teekay Corporation reimbursed us \$0.7 million of these costs during the year ended December 31, 2008.
- (q) In March 2008, a subsidiary of OPCO sold certain vessel equipment to a subsidiary of Teekay Corporation for proceeds equal to its net book value of \$1.4 million.
- (r) Concurrently with the closing of our public offering of common units in June 2008, we acquired from Teekay Corporation an additional 25% interest in OPCO for \$205.5 million, thereby increasing our ownership interest in OPCO to 51%. We financed the acquisition with the net proceeds from the public offering and a concurrent private placement of common units to Teekay Corporation. See Note 2. In connection with the valuation of the purchase of the additional 25% interest in OPCO, we incurred a fairness opinion fee of \$1.1 million. The excess of the proceeds paid by us over Teekay Corporation's historical book value for the 25% interest in OPCO was accounted for as an equity distribution to Teekay Corporation of \$91.6 million.
- (s) On June 18, 2008, OPCO acquired from Teekay Corporation two ship owning subsidiaries (SPT Explorer L.L.C. and the SPT Navigator L.L.C.) for a total cost of approximately \$106.0 million, including the assumption of third-party debt of approximately \$89.3 million and the non-cash settlement of related party working capital of \$1.2 million. The acquired subsidiaries own two 2008-built Aframax lightering tankers (the *SPT Explorer* and the *SPT Navigator*) and their related 10-year, fixed-rate bareboat charters (with options exercisable by the charterer to extend up to an additional five years) entered into with Skaugen PetroTrans, a joint venture in which Teekay Corporation owns a 50% interest. These two lightering tankers are specially designed to be used in ship-to-ship oil transfer operations. This purchase was financed with the assumption of debt, together with cash balances. The excess of the proceeds paid by us over Teekay Corporation's historical book value was accounted for as an equity distribution to Teekay Corporation of \$16.2 million. Pursuant to the bareboat charters for the vessels, OPCO earned voyage revenues of \$8.7 million for 2008 (including voyage revenues earned as part of the Dropdown Predecessor prior to OPCO's acquisition of the vessels – see Note 1).
- (t) In June 2008, Teekay Corporation agreed to reimburse OPCO for certain costs relating to events which occurred prior to our initial public offering in December 2006, totalling \$0.7 million, primarily relating to the settlement of repair costs not covered by insurance providers for work performed in early 2006 on two of OPCO's shuttle tankers.
- (u) At December 31, 2008, due from affiliates totaled \$10.1 million and due to affiliates totaled \$8.7 million. Due to and from affiliate are non-interest bearing and unsecured.
- (v) During August 2008, one of OPCO's in-chartered shuttle tankers was employed on a single-voyage charter with a subsidiary of Teekay Corporation. Pursuant to this charter contract, OPCO earned voyage revenues of \$11.3 million for 2008.

Item 8. Financial Information

A. Consolidated Financial Statements and Other Financial Information

Consolidated Financial Statements and Notes

Please see Item 18 below for additional information required to be disclosed under this Item.

Legal Proceedings

On November 13, 2006, a Teekay Offshore Operating L.P. (or *OPCO*) shuttle tanker, the *Navion Hispania*, collided with the *Njord Bravo*, a floating storage and offtake unit, while preparing to load an oil cargo from the *Njord Bravo*. The *Njord Bravo* services the Njord field, which is operated by StatoilHydro Petroleum AS (or *StatoilHydro*) and is located off the Norwegian coast. At the time of the incident, StatoilHydro was chartering the *Navion Hispania* from OPCO. The *Navion Hispania* and the *Njord Bravo* both incurred damages as a result of the collision.

In November 2007, Navion Offshore Loading AS, a subsidiary of OPCO, and two subsidiaries of Teekay Corporation were named as co-defendants in a legal action filed by Norwegian Hull Club (the hull and machinery insurers of the *Njord Bravo*), StatoilHydro and various licensees in the Njord field. The claim seeks damages for vessel repairs, expenses for a replacement vessel and other amounts related to production stoppage on the field, totaling NOK256,000,000 (or approximately USD\$39 million). As anticipated, the Stavanger Conciliation Council has referred the matter to the Stavanger District Court. The claimants must continue the proceedings by December 31, 2009 in order to avoid the matter being time-barred.

We believe the likelihood of any losses relating to the claim is remote. The Partnership believes that the charter contract relating to the *Navion Hispania* requires that StatoilHydro be responsible and indemnify Navion Offshore Loading AS for all losses relating to the damage to the *Njord Bravo*. OPCO and Teekay Corporation also maintain insurance for damages to the *Navion Hispania* and insurance for collision-related costs and claims. The Partnership believes that these insurance policies will cover the costs related to this incident, including any costs not indemnified by StatoilHydro, subject to standard deductibles. In addition, Teekay Corporation has agreed to indemnify the Partnership, OPCO and OPCO's subsidiaries for any losses they may incur in connection with this incident.

In addition, from time to time we have been, and expect to continue to be, subject to legal proceedings and claims in the ordinary course of our business, principally personal injury and property casualty claims. These claims, even if lacking merit, could result in the expenditure of significant financial and managerial resources. We are not aware of any legal proceedings or claims that we believe will have, individually or in the aggregate, a material adverse effect on us.

Cash Distribution Policy

Rationale for Our Cash Distribution Policy

Our cash distribution policy reflects a basic judgment that our unitholders are better served by our distributing our cash available (as defined in our partnership agreement and after deducting expenses, including estimated maintenance capital expenditures and reserves) rather than our retaining it. Because we believe we will generally finance any expansion capital expenditures from external financing sources, we believe that our investors are best served by our distributing all of our available cash. Our cash distribution policy is consistent with the terms of our partnership agreement, which requires that we distribute all of our available cash quarterly (after deducting expenses, including estimated maintenance capital expenditures and reserves).

Limitations on Cash Distributions and Our Ability to Change Our Cash Distribution Policy

There is no guarantee that unitholders will receive quarterly distributions from us. Our distribution policy is subject to certain restrictions and may be changed at any time, including:

- Our unitholders have no contractual or other legal right to receive distributions other than the obligation under our partnership agreement to distribute available cash on a quarterly basis, which is subject to our general partner's broad discretion to establish reserves and other limitations.
- The Board of Directors of OPCO's general partner, Teekay Offshore Operating GP L.L.C. (subject to approval by the Board of Directors of our general partner), has authority to establish reserves for the prudent conduct of OPCO's business. The establishment of these reserves could result in a reduction in cash distributions.
- While our partnership agreement requires us to distribute all of our available cash, our partnership agreement, including provisions requiring us to make cash distributions contained therein, may be amended. Although during the subordination period (defined in our partnership agreement), with certain exceptions, our partnership agreement may not be amended without the approval of non-affiliated common unitholders, our partnership agreement can be amended with the approval of a majority of the outstanding common units after the subordination period has ended.
- Even if our cash distribution policy is not modified or revoked, the amount of distributions we pay under our cash distribution policy and the decision to make any distribution is determined by the Board of Directors of our general partner, taking into consideration the terms of our partnership agreement.
- Under Section 51 of the Marshall Islands Limited Partnership Act, we may not make a distribution to unitholders if the distribution would cause our liabilities to exceed the fair value of our assets.
- We may lack sufficient cash to pay distributions to our unitholders due to decreases in net voyage revenues or increases in operating expenses, principal and interest payments on outstanding debt, tax expenses, working capital requirements, maintenance capital expenditures or anticipated cash needs.

- Our distribution policy may be affected by restrictions on distributions under our and OPCO's credit facility agreements, which contain material financial tests and covenants that must be satisfied. Should we or OPCO be unable to satisfy these restrictions included in the credit agreements or if we or OPCO is otherwise in default under the credit agreements, we or it would be prohibited from making cash distributions, which would materially hinder our ability to make cash distributions to unitholders, notwithstanding our stated cash distribution policy.
- If we make distributions out of capital surplus, as opposed to operating surplus (as such terms are defined in our partnership agreement), such distributions will constitute a return of capital and will result in a reduction in the minimum quarterly distribution and the target distribution levels under our partnership agreement. We do not anticipate that we will make any distributions from capital surplus.

Minimum Quarterly Distribution

Common unitholders are entitled under our partnership agreement to receive a minimum quarterly distribution of \$0.45 per unit, or \$1.80 per unit per year, prior to any distribution on our subordinated units to the extent we have sufficient cash from our operations after establishment of cash reserves and payment of fees and expenses, including payments to our general partner. Our general partner has the authority to determine the amount of our available cash for any quarter. This determination must be made in good faith. There is no guarantee that we will pay the minimum quarterly distribution on the common units in any quarter, and we will be prohibited from making any distributions to unitholders if it would cause an event of default, or if an event of default exists, under our credit agreements.

Commencing after the date of our initial public offering until the third quarter of 2007, cash distributions declared were \$0.35 per unit per quarter. For the quarter ended December 31, 2006, cash distributions declared were prorated for the period of December 19, 2006 to December 31, 2006. Our cash distributions were increased to \$0.385 per unit and \$0.40 per unit for distributions effective for the third and fourth quarter of 2007, respectively. Our cash distribution has increased to \$0.45 per unit starting with the third quarter of 2008.

Subordination Period

During the subordination period applicable to the subordinated units held by Teekay Corporation, the common units have the right to receive distributions of available cash from operating surplus in an amount equal to the minimum quarterly distribution, plus any arrearages in the payment of the minimum quarterly distribution on the common units from prior quarters, before any distributions of available cash from operating surplus may be made on the subordinated units. The purpose of the subordinated units is to increase the likelihood that during the subordination period there will be available cash to be distributed on the common units.

Incentive Distribution Rights

Incentive distribution rights represent the right to receive an increasing percentage of quarterly distributions of available cash from operating surplus (as defined in our partnership agreement) after the minimum quarterly distribution and the target distribution levels have been achieved. Our general partner currently holds the incentive distribution rights, but may transfer these rights separately from its general partner interest, subject to restrictions in our partnership agreement. Except for transfers of incentive distribution rights to an affiliate or another entity as part of our general partner's merger or consolidation with or into, or sale of all or substantially all of its assets to such entity, the approval of a majority of our common units (excluding common units held by our general partner and its affiliates), voting separately as a class, generally is required for a transfer of the incentive distributions rights to a third party prior to December 31, 2016.

The following table illustrates the percentage allocations of the additional available cash from operating surplus among the unitholders and our general partner up to the various target distribution levels. The amounts set forth under "Marginal Percentage Interest in Distributions" are the percentage interests of the unitholders and our general partner in any available cash from operating surplus we distribute up to and including the corresponding amount in the column "Total Quarterly Distribution Target Amount," until available cash from operating surplus we distribute reaches the next target distribution level, if any. The percentage interests shown for the unitholders and our general partner for the minimum quarterly distribution are also applicable to quarterly distribution amounts that are less than the minimum quarterly distribution. The percentage interests shown for our general partner include its 2% general partner interest and assume the general partner has contributed any capital necessary to maintain its 2.0% general partner interest and has not transferred the incentive distribution rights.

	<u>Total Quarterly Distribution Target Amount</u>	<u>Marginal Percentage Interest in Distributions</u>	
		<u>Unitholders</u>	<u>General Partner</u>
Minimum Quarterly Distribution	\$0.35	98.0%	2.0%
First Target Distribution	Up to \$0.4025	98.0%	2.0%
Second Target Distribution	Above \$0.4025 up to \$0.4375	85.0%	15.0%
Third Target Distribution	Above \$0.4375 up to \$0.525	75.0%	25.0%
Thereafter	Above \$0.525	50.0%	50.0%

B. Significant Changes

No significant changes have occurred since the date of the annual financial statements included herein.

Item 9. The Offer and Listing

Our common units are traded on the NYSE under the symbol "TOO". The following table sets forth the high and low closing sales prices for our common units on the NYSE for each of the periods indicated:

Year Ended	Dec. 31, 2008	Dec. 31, 2007	Dec. 31, 2006 ⁽¹⁾						
High	\$26.46	\$37.45	\$26.77						
Low	6.58	24.04	21.00						
Quarter Ended	Dec. 31, 2008	Sept. 30, 2008	June 30, 2008	Mar. 31, 2008	Dec. 31, 2007	Sept 30, 2007	Jun 30, 2007	Mar 31, 2007	
High	\$14.05	\$19.69	\$24.35	\$26.46	\$29.38	\$37.45	\$35.40	\$31.66	
Low	6.58	11.25	19.74	20.71	24.04	28.00	29.79	26.00	
Months Ended	May 31, 2009	Apr. 30, 2009	Mar. 31, 2009	Feb 29, 2009	Jan 31, 2009	Dec. 31, 2008			
High	\$13.92	\$14.07	\$13.36	\$14.37	\$14.89	\$12.26			
Low	\$12.77	11.76	9.75	11.13	12.53	8.80			

(1) Period beginning December 13, 2006.

Item 10. Additional Information

Memorandum and Articles of Association

The information required to be disclosed under Item 10.B is incorporated by reference to the following sections of the Rule 424(b) prospectus filed with the SEC on December 14, 2006: "The Partnership Agreement," "Description of the Common Units – The Units," "Conflicts of Interest and Fiduciary Duties" and "Our Cash Distribution Policy and Restrictions on Distributions."

Material Contracts

The following is a summary of each material contract, other than material contracts entered into in the ordinary course of business, to which we or any of our subsidiaries is a party, for the two years immediately preceding the date of this Annual Report, each of which is included in the list of exhibits in Item 19:

- a) Agreement, dated June 26, 2003, for a U.S. \$455,000,000 Revolving Credit Facility between Norsk Teekay Holdings Ltd., Den Norske Bank ASA and various other banks. This facility bears interest at LIBOR plus a margin of 0.625%. The amount available under the facility reduces semi-annually, with a bullet reduction of \$131.0 million on maturity in October 2014. The credit facility may be used for acquisitions and for general partnership purposes. Our obligations under the facility are secured by first-priority mortgages on seven shuttle tankers and one FSO unit.
- b) Agreement, dated October 2, 2006, for a U.S. \$940,000,000 Revolving Credit Facility between Teekay Offshore Operating L.P., Den Norske Bank ASA and various other banks. This facility bears interest at LIBOR plus a margin of 0.625%. The amount available under the facility reduces semi-annually, with a bullet reduction of \$350.0 million on maturity in October 2014. The credit facility may be used for acquisitions and for general partnership purposes. In addition, this facility allows OPCO to make working capital borrowings and loan the proceeds to us, which we could use to make distributions, provided that such amounts are paid down annually. Our obligations under the facility are secured by first-priority mortgages on 11 shuttle tankers and eight conventional tankers.
- c) Amended and Restated Omnibus Agreement, dated December 19, 2006, among us, our general partner, Teekay Corporation, Teekay LNG and related parties. Please read Item 7 – Major Unitholders and Related Party Transactions for a summary of certain contract terms.
- d) We, OPCO and certain of our and its operating subsidiaries have entered into services agreements with certain subsidiaries of Teekay Corporation pursuant to which the Teekay Corporation subsidiaries provide us, OPCO, and our and its operating subsidiaries with administrative, advisory, technical, strategic consulting services and ship management services for a reasonable fee that includes reimbursement of their direct and indirect expenses incurred in providing these services. Please read Item 7 – Major Unitholders and Related Party Transactions for a summary of certain contract terms.
- e) Teekay Offshore Partners L.P. 2006 Long-Term Incentive Plan. Please read Item 6 – Directors, Senior Management and Employees for a summary of certain plan terms.

Exchange Controls and Other Limitations Affecting Unitholders

We are not aware of any governmental laws, decrees or regulations, including foreign exchange controls, in the Republic of The Marshall Islands that restrict the export or import of capital, or that affect the remittance of dividends, interest or other payments to non-resident holders of our securities.

We are not aware of any limitations on the right of non-resident or foreign owners to hold or vote our securities imposed by the laws of the Republic of The Marshall Islands or our partnership agreement.

Material U.S. Federal Income Tax Considerations

The following is a discussion of the material U.S. federal income tax considerations that may be relevant to unitholders. This discussion is based upon provisions of the Internal Revenue Code of 1986, as amended (or the *Code*) as in effect on the date of this Annual Report, existing final and temporary regulations thereunder (or *Treasury Regulations*), and current administrative rulings and court decisions, all of which are subject to change, possibly with retroactive effect. Changes in these authorities may cause the tax consequences to vary substantially from the consequences described below. Unless the context otherwise requires, references in this section to “we,” “our” or “us” are references to Teekay Offshore Partners, L.P.

The following summary does not comment on all aspects of U.S. federal income taxation which may be important to particular unitholders in light of their individual circumstances, such as unitholders subject to special tax rules (e.g., financial institutions, insurance companies, broker-dealers, tax-exempt organizations, or former citizens or long-term residents of the United States) or to persons that will hold the common units as part of a straddle, hedge, conversion, constructive sale, or other integrated transaction for U.S. federal income tax purposes, partnerships or their partners, or to persons that have a functional currency other than the U.S. dollar, all of whom may be subject to tax rules that differ significantly from those summarized below. If a partnership or other entity taxed as a pass-through entity holds our common units, the tax treatment of a partner or owner thereof generally will depend upon the status of the partner or owner and upon the activities of the partnership or pass-through entity. If you are a partner in a partnership or owner of a pass-through entity holding our common units, you should consult your tax advisor.

This summary does not discuss any U.S. state or local, estate or alternative minimum tax considerations regarding the ownership or disposition of common units. This summary is written for unitholders that hold their common units as a “capital asset” under the Code. Each unitholder is urged to consult its tax advisor regarding the U.S. federal, state, local and other tax consequences of the ownership or disposition of common units.

United States Federal Income Taxation of U.S. Holders

As used herein, the term U.S. Holder means a beneficial owner of our common units that is a U.S. citizen or resident (as determined for U.S. federal income tax purposes), U.S. corporation or other U.S. entity taxable as a corporation, an estate the income of which is subject to U.S. federal income taxation regardless of its source, or a trust if a court within the United States is able to exercise primary jurisdiction over the administration of the trust and one or more U.S. persons have the authority to control all substantial decisions of the trust.

Distributions

We have elected to be taxed as a corporation for U.S. federal income tax purposes. Subject to the discussion of passive foreign investment companies (or *PFICs*) below, any distributions made by us with respect to our common units to a U.S. Holder generally will constitute dividends, which may be taxable as ordinary income or “qualified dividend income” as described in more detail below, to the extent of our current or accumulated earnings and profits, as determined under U.S. federal income tax principles. Distributions in excess of our earnings and profits will be treated first as a nontaxable return of capital to the extent of the U.S. Holder’s tax basis in its common units on a dollar-for-dollar basis and thereafter as capital gain. U.S. Holders that are corporations generally will not be entitled to claim a dividends received deduction with respect to any distributions they receive from us. Dividends paid with respect to our common units generally will be treated as “passive category income” or, in the case of certain types of U.S. Holders, “general category income” for purposes of computing allowable foreign tax credits for U.S. federal income tax purposes.

Dividends paid on our common units to a U.S. Holder who is an individual, trust or estate (or a *U.S. Individual Holder*) will be treated as “qualified dividend income” that currently is taxable to such U.S. Individual Holder at preferential capital gain tax rates provided that: (i) our common units are readily tradable on an established securities market in the United States (such as the New York Stock Exchange on which our common units are traded); (ii) we are not a PFIC for the taxable year during which the dividend is paid or the immediately preceding taxable year (which we do not believe we are, have been or will be, as discussed below); (iii) the U.S. Individual Holder has owned the common units for more than 60 days in the 121-day period beginning 60 days before the date on which the common units become ex-dividend; and (iv) the U.S. Individual Holder is not under an obligation to make related payments with respect to positions in substantially similar or related property. There is no assurance that any dividends paid on our common units will be eligible for these preferential rates in the hands of a U.S. Individual Holder. Any dividends paid on our common units not eligible for these preferential rates will be taxed as ordinary income to a U.S. Individual Holder. In the absence of legislation extending the term of the preferential tax rates for qualified dividend income, all dividends received by a taxpayer in tax years beginning on January 1, 2011 or later will be taxed at ordinary graduated tax rates.

Special rules may apply to any “extraordinary dividend” paid by us. An extraordinary dividend is, generally, a dividend with respect to a share of stock if the amount of the dividend is equal to or in excess of 10.0% of a stockholder’s adjusted basis (or fair market value in certain circumstances) in such stock. If we pay an “extraordinary dividend” on our common units that is treated as “qualified dividend income,” then any loss derived by a U.S. Individual Holder from the sale or exchange of such common units will be treated as long-term capital loss to the extent of such dividend.

Consequences of Possible PFIC Classification

A non-U.S. entity treated as a corporation for U.S. federal income tax purposes will be a PFIC in any taxable year in which, after taking into account the income and assets of the corporation and certain subsidiaries pursuant to a “look through” rule, either: (i) at least 75.0% of its gross income is “passive” income; or (ii) at least 50.0% of the average value of its assets is attributable to assets that produce passive income or are held for the production of passive income.

For purposes of these tests, “passive income” includes dividends, interest, and gains from the sale or exchange of investment property and rents and royalties other than rents and royalties that are received from unrelated parties in connection with the active conduct of a trade or business. For purposes of these tests, income derived from the performance of services does not constitute “passive income.” We do not believe that our existing operations would cause us to be deemed a PFIC with respect to any taxable year, as we treat the gross income we derive from our time and voyage charters and our contracts of affreightment as services income, rather than rental income.

There is, however, no direct legal authority under the PFIC rules addressing our method of operation and, therefore no assurance can be given that the IRS will accept this position or that we would not constitute a PFIC for any future taxable year if there were to be changes in our assets, income or operations. Moreover, a recent decision of the United States Court of Appeals for the Fifth Circuit in *Tidewater Inc. v. United States*, No. 08-30268

(5th Cir. Apr. 13, 2009) held that income derived from certain time chartering activities should be treated as rental income rather than services income. However, the issues in this case arose under the foreign sales corporation rules of the Code and did not concern the PFIC rules. In addition, the court's ruling was contrary to the position of the Internal Revenue Service (or IRS) that the time charter income should be treated as services income. As a result, it is uncertain whether the principles of the *Tidewater* decision would be applicable to our operations. However, if the principles of the *Tidewater* decision were applicable to our operations, we likely would be treated as a PFIC.

While there are legal uncertainties involved in this determination, we do not believe that we should be a PFIC based principally on the position that we derive at least a majority of our gross income from our time and voyage charters (which generally is not passive income). Correspondingly, the assets that we own and operate in connection with the production of such income, in particular the vessels operating under time or voyage charters, should not constitute passive assets for purposes of determining whether we are a PFIC. Legal authority concerning the characterization of income derived from time charters, voyage charters and similar contracts for other tax purposes supports this position. Because there is no legal authority specifically relating to the statutory provisions governing PFICs, the IRS or a court could disagree with this position. In addition, there is no assurance that the nature of our assets, income and operations will remain the same in the future.

If we were classified as a PFIC, for any year during which a U.S. Holder owns common units, such U.S. Holder generally will be subject to special rules (regardless of whether we continue thereafter to be a PFIC) with respect to: (i) any "excess distribution" (generally, any distribution received by a unitholder in a taxable year that is greater than 125.0% of the average annual distributions received by the unitholder in the three preceding taxable years or, if shorter, the unitholder's holding period for the shares), and (ii) any gain realized upon the sale or other disposition of units. Under these rules:

- the excess distribution or gain will be allocated ratably over the unitholder's holding period;
- the amount allocated to the current taxable year and any year prior to the first year in which we were a PFIC will be taxed as ordinary income in the current year;
- the amount allocated to each of the other taxable years in the unitholder's holding period will be subject to U.S. federal income tax at the highest rate in effect for the applicable class of taxpayer for that year; and
- an interest charge for the deemed deferral benefit will be imposed with respect to the resulting tax attributable to each such other taxable year.

Certain elections that would alter the tax consequences to a U.S. Holder, such as a qualified electing fund election or mark to market election, may be available to a U.S. Holder if we are classified as a PFIC. If we determine that we are or will be a PFIC, we will provide unitholders with information concerning the potential availability of such elections.

As described above, current law provides that dividends received by a U.S. Individual Holder from a qualified foreign corporation are subject to U.S. federal income tax at preferential rates through 2010. However, if we are classified as a PFIC for a taxable year in which we pay a dividend or the immediately preceding taxable year, we would not be considered a qualified foreign corporation, and a U.S. Individual Holder receiving such dividends would not be eligible for the reduced rate of U.S. federal income tax.

Consequences of Possible Controlled Foreign Corporation Classification

If more than 50.0% of either the total combined voting power of our outstanding units entitled to vote or the total value of all of our outstanding units were owned, directly, indirectly or constructively, by citizens or residents of the United States, U.S. partnerships or corporations, or U.S. estates or trusts (as defined for U.S. federal income tax purposes), each of which owned, directly, indirectly or constructively, 10.0% or more of the total combined voting power of our outstanding units entitled to vote (each, a *United States Stockholder*), we generally would be treated as a controlled foreign corporation (or CFC). United States Stockholders of a CFC are treated as receiving current distributions of their shares of certain income of the CFC (not including, under current law, certain undistributed earnings attributable to shipping income) without regard to any actual distributions and are subject to other burdensome U.S. federal income tax and administrative requirements but generally are not also subject to the requirements generally applicable to owners of a PFIC. Although we currently are not a CFC, U.S. persons purchasing a substantial interest in us should consult their tax advisors about the potential implications of being treated as a United States Stockholder in the event we were to become a CFC in the future.

Sale, Exchange or other Disposition of Common Units

Assuming we do not constitute a PFIC for any taxable year, a U.S. Holder generally will recognize taxable gain or loss upon a sale, exchange or other disposition of our common units in an amount equal to the difference between the amount realized by the U.S. Holder from such sale, exchange or other disposition and the U.S. Holder's tax basis in such units. Subject to the discussion of extraordinary dividends above, such gain or loss will be treated as long-term capital gain or loss if the U.S. Holder's holding period is greater than one year at the time of the sale, exchange or other disposition, and subject to preferential capital gain tax rates. Such capital gain or loss will generally be treated as U.S.-source gain or loss, as applicable, for U.S. foreign tax credit purposes. A U.S. Holder's ability to deduct capital losses is subject to certain limitations. A disposition or sale of units by a shareholder who owns, or has owned, 10.0% or more of the total voting power of us may result in a different tax treatment under section 1248 of the Code. U.S. Holder's purchasing a substantial interest in us should consult their tax advisors.

United States Federal Income Taxation of Non-U.S. Holders

A beneficial owner of our common units (other than a partnership, including any entity or arrangement treated as a partnership for U.S. federal income tax purposes) that is not a U.S. Holder is a *Non-U.S. Holder*.

Distributions

Distributions we pay to a Non-U.S. Holder will not be subject to U.S. federal income tax or withholding tax if the Non-U.S. Holder is not engaged in a U.S. trade or business. If the Non-U.S. Holder is engaged in a U.S. trade or business, distributions we pay will be subject to U.S. federal income tax to the extent those distributions constitute income effectively connected with that Non-U.S. Holder's U.S. trade or business. However, distributions

paid to a Non-U.S. Holder who is engaged in a trade or business may be exempt from taxation under an income tax treaty if the income represented thereby is not attributable to a U.S. permanent establishment maintained by the Non-U.S. Holder.

Disposition of Common Units

The U.S. federal income taxation of Non-U.S. Holders on any gain resulting from the disposition of our common units generally is the same as described above regarding distributions. However, individual Non-U.S. Holders may be subject to tax on gain resulting from the disposition of our common units if they are present in the United States for 183 days or more during the taxable year in which those shares are disposed and meet certain other requirements.

Backup Withholding and Information Reporting

In general, payments of distributions or the proceeds of a disposition of common units to a non-corporate U.S. Holder will be subject to information reporting requirements. These payments to a non-corporate U.S. Holder also may be subject to backup withholding if the non-corporate U.S. Holder:

- fails to provide an accurate taxpayer identification number;
- is notified by the IRS that it has failed to report all interest or distributions required to be shown on its U.S. federal income tax returns; or
- in certain circumstances, fails to comply with applicable certification requirements.

Non-U.S. Holders may be required to establish their exemption from information reporting and backup withholding on payments within the United States by certifying their status on IRS Form W-8BEN, W-8ECI or W-8IMY, as applicable.

Backup withholding is not an additional tax. Rather, a unitholder generally may obtain a credit for any amount withheld against its liability for U.S. federal income tax (and a refund of any amounts withheld in excess of such liability) by filing a return with the IRS.

Non-United States Tax Consequences

Marshall Islands Tax Consequences. Because we and our subsidiaries do not, and we do not expect that we and our subsidiaries will, conduct business or operations in the Republic of The Marshall Islands, and because all documentation related to our initial public offering was executed outside of the Republic of The Marshall Islands, under current Marshall Islands law, no taxes or withholdings will be imposed by the Republic of The Marshall Islands on distributions, including upon a return of capital, made to unitholders, so long as such persons do not reside in, maintain offices in, nor engage in business in the Republic of The Marshall Islands. Furthermore, no stamp, capital gains or other taxes will be imposed by the Republic of The Marshall Islands on the purchase, ownership or disposition by such persons of our common units.

Canadian Federal Income Tax Consequences. The following discussion is a summary of the material Canadian federal income tax consequences under the Income Tax Act (Canada) (or the *Canada Tax Act*), that we believe are relevant to holders of common units who are, at all relevant times, for the purposes of the Canada Tax Act and the Canada-United States Tax Convention 1980 (or the *Canada-U.S. Treaty*) resident in the United States and who deal at arm's length with us and Teekay Corporation (or *U.S. Resident Holders*).

Under the Canada Tax Act, no taxes on income (including taxable capital gains) are payable by U.S. Resident Holders in respect of the acquisition, holding, disposition or redemption of the common units, provided that we do not carry on business in Canada and such U.S. Resident Holders do not, for the purposes of the Canada-U.S. Treaty, otherwise have a permanent establishment or fixed base in Canada to which such common units pertain and, in addition, do not use or hold and are not deemed or considered to use or hold such common units in the course of carrying on a business in Canada and, in the case of any U.S. Resident Holders that carry on an insurance business in Canada and elsewhere, such U.S. Resident Holders establish that the common units are not effectively connected with their insurance business carried on in Canada.

In this connection, we believe that our activities and affairs and the activities and affairs of OPCO, a Marshall Island Limited Partnership in which we own a 26.0% limited partnership interest, are conducted in a manner that both we and OPCO are not carrying on business in Canada. As a result, U.S. Resident Holders should not be considered to be carrying on business in Canada for purposes of the Canada Tax Act solely by reason of the acquisition, holding, disposition or redemption of their common units. We intend that this is the case, notwithstanding that certain services will be provided to Teekay Offshore Partners L.P., OPCO and its operating subsidiaries indirectly through arrangements with a subsidiary of Teekay Corporation that is resident and based in Bermuda, by Canadian service providers. However we cannot assure this result.

Documents on Display

Documents concerning us that are referred to herein may be inspected at our principal executive headquarters at 4th Floor, Belvedere Building, 69 Pitts Bay Road, Hamilton, HM 08, Bermuda. Those documents electronically filed via the SEC's Electronic Data Gathering, Analysis, and Retrieval (or *EDGAR*) system may also be obtained from the SEC's website at www.sec.gov, free of charge, or from the SEC's Public Reference Section at 100 F Street, NE, Washington, D.C. 20549, at prescribed rates. Further information on the operation of the SEC public reference rooms may be obtained by calling the SEC at 1-800-SEC-0330.

Item 11. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Risk

We are exposed to the impact of interest rate changes primarily through our floating-rate borrowings. Significant increases in interest rates could adversely affect operating margins, results of operations and our ability to service debt. From time to time, we use interest rate swaps to reduce exposure to market risk from changes in interest rates. The principal objective of these contracts is to minimize the risks and costs associated with the floating-rate debt.

In order to minimize counterparty risk, we only enter into derivative transactions with counterparties that are rated A or better by Standard & Poor's or Aa3 by Moody's at the time of the transactions. In addition, to the extent possible and practical, interest rate swaps are entered into with different counterparties to reduce concentration risk.

The tables below provide information about financial instruments as at December 31, 2008 that are sensitive to changes in interest rates. For debt obligations, the table presents principal payments and related weighted-average interest rates by expected maturity dates. For interest rate swaps, the table presents notional amounts and weighted-average interest rates by expected contractual maturity dates.

	Expected Maturity Date						Total	Fair Value Asset/(Liability)	Rate ⁽¹⁾
	2009	2010	2011	2012	2013	Thereafter			
(in millions of U.S. dollars, except percentages)									
Long-Term Debt:									
U.S Dollar- denominated ⁽²⁾	125.5	134.7	169.3	147.1	155.4	834.4	1,566.4	(1,476.6)	3.4%
Interest Rate Swaps:									
Contract Amount ⁽³⁾	552.5	18.1	18.6	19.2	19.9	703.8	1,332.3	(159.2)	4.8%
Average Fixed Pay Rate ⁽²⁾	4.7%	4.9%	4.9%	4.9%	4.9%	4.8%	4.8%		

(1) Rate refers to the weighted-average effective interest rate for our debt, including the margin paid on our floating-rate debt and the average fixed pay rate for interest rate swaps. The average fixed pay rate for interest rate swaps excludes the margin paid on the floating-rate debt, which as of December 31, 2008 ranged from 0.45% to 0.95%.

(2) Interest payments on floating-rate debt and interest rate swaps are based on LIBOR.

(3) The average variable receive rate for interest rate swaps is set quarterly at the 3-month LIBOR or semi-annually at 6-month LIBOR.

Foreign Currency Fluctuation Risk

Our functional currency is U.S. dollars because virtually all of our revenues and most of our operating costs are in U.S. Dollars. We incur certain vessel operating expenses and general and administrative expenses in foreign currencies, the most significant of which is the Norwegian Kroner and, to a lesser extent, Australian Dollars, Euros and Singapore Dollars. For the years ended December 31, 2008 and 2007, approximately 49.1% and 52.6%, respectively, of vessel operating costs and general and administrative expenses were denominated in Norwegian Kroner. There is a risk that currency fluctuations will have a negative effect on the value of cash flows.

On the closing of our initial public offering, OPCO entered into services agreements with subsidiaries of Teekay Corporation whereby the subsidiaries operate and crew OPCO's vessels. Under the services agreements, the applicable subsidiaries of Teekay Corporation are paid in U.S. dollars for reasonable direct and indirect expenses incurred in providing the services. A substantial majority of those expenses are in Norwegian Kroner. The Teekay Corporation subsidiaries were paid under the services agreements based on a fixed U.S. Dollar/Norwegian Kroner exchange rate until December 31, 2008. The exchange rate is no longer fixed under these agreements, which may result in increased payments by us if the strength of the U.S. Dollar declines relative to the Norwegian Kroner.

We may continue to seek to hedge these currency fluctuation risks in the future. At December 31, 2008, we were committed to the following foreign currency forward contracts:

	Contract Amount in Foreign Currency (millions)	Average Forward Rate ⁽¹⁾	Expected Maturity	
			2009 (in millions of U.S. Dollars)	2010
Norwegian Kroner	1,228.8	5.83	114.7	96.1
Australian Dollar	3.3	1.12	3.0	-
British Pound	0.4	0.52	0.7	0.1
Euro	24.7	0.69	23.7	12.2
			\$142.1	\$108.4

(1) Average forward rate represents the contracted amount of foreign currency one U.S. Dollar will buy.

To the extent the hedge is effective, changes in the fair value of the forward contract are either offset against the fair value of assets or liabilities through income, or recognized in other comprehensive income until the hedged item is recognized in income. The ineffective portion of a forward contract's change in fair value is immediately recognized in income.

Although the majority of transactions, assets and liabilities are denominated in U.S. Dollars, OPCO had Norwegian Kroner-denominated deferred income taxes of approximately 61.2 million (\$8.8 million) at December 31, 2008. Neither we nor OPCO has entered into any forward contracts to protect against currency fluctuations on any future taxes.

Commodity Price Risk

We are exposed to changes in forecasted bunker fuel costs for certain vessels being time-chartered-out and for vessels servicing certain contracts of affreightment. We may use bunker fuel swap contracts as economic hedges to protect against changes in bunker fuel costs. As at December 31, 2008, we are not committed to any bunker fuel swap contracts.

Item 12. Description of Securities Other than Equity Securities

Not applicable.

Item 13. Defaults, Dividend Arrearages and Delinquencies

None.

Item 14. Material Modifications to the Rights of Unitholders and Use of Proceeds

None.

Item 15. Controls and Procedures

We conducted an evaluation of our disclosure controls and procedures under the supervision and with the participation of the Chief Executive Officer and Chief Financial Officer of our general partner. Based on the evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of December 31, 2008 to ensure that information required to be disclosed by us in the reports we file or submit under the Securities and Exchange Act of 1934 is accumulated and communicated to our management, including the principal executive and principal financial officers of our general partner, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

During 2008, management implemented a change in our internal control over financial reporting which resulted in a more rigorous process to determine the appropriate accounting treatment for complex accounting issues such as hedge accounting and non-routine, complex financial structures and arrangements, including the engagement of appropriately qualified external expertise.

Aside from the item discussed above, during 2008 there were no changes in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

The Chief Executive Officer and Chief Financial Officer of our general partner do not expect that our disclosure controls or internal controls will prevent all error and all fraud. Although our disclosure controls and procedures were designed to provide reasonable assurance of achieving their objectives, a control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within us have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls also is based partly on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

Management's Report on Internal Control over Financial Reporting

Management of our general partner is responsible for establishing and maintaining for us adequate internal controls over financial reporting.

Our internal controls were designed to provide reasonable assurance as to the reliability of our financial reporting and the preparation and presentation of the consolidated financial statements for external purposes in accordance with accounting principles generally accepted in the United States. Our internal controls over financial reporting includes those policies and procedures that, 1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets; 2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of the financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made in accordance with authorizations of management and the directors of our general partnership; and 3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

We conducted an evaluation of the effectiveness of our internal control over financial reporting based upon the framework in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. This evaluation included review of the documentation of controls, evaluation of the design effectiveness of controls, testing of the operating effectiveness of controls and a conclusion on this evaluation.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements even when determined to be effective and can only provide reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate. However, based on the evaluation, management believes that we maintained effective internal control over financial reporting as of December 31, 2008.

Our independent auditors, Ernst & Young LLP, a registered public accounting firm has audited the accompanying consolidated financial statements and our internal control over financial reporting. Their attestation report on the effectiveness of our internal control over financial reporting can be found on page F-2 of this Annual Report.

Item 16A. Audit Committee Financial Expert

The Board of Directors of our general partner has determined that director David L. Lemmon qualifies as an audit committee financial expert and is independent under applicable NYSE and SEC standards.

Item 16B. Code of Ethics

Our general partner has adopted Standards of Business Conduct that include a Code of Ethics for all our employees and the employees and directors of our general partner. This document is available under "Other Information - Partnership Governance" in the Investor Centre of our web site (www.teekayoffshore.com). We intend to disclose, under "Other Information - Partnership Governance" in the Investor Centre of our web site, any waivers to or amendments of the Code of Ethics for the benefit of any directors and executive officers of our general partner.

Item 16C. Principal Accountant Fees and Services

Our principal accountant for 2008 and 2007 was Ernst & Young LLP, Chartered Accountants. The following table shows the fees we or our predecessor paid or accrued for audit services provided by Ernst & Young LLP for 2008 and 2007.

Fees	2008	2007
Audit Fees ⁽¹⁾	\$1,355,500	\$437,800
Tax Fees ⁽²⁾	3,400	15,800
Total	<u>\$1,358,900</u>	<u>\$453,600</u>

(1) Audit fees represent fees for professional services provided in connection with the audit of our consolidated financial statements, review of our quarterly consolidated financial statements and audit services provided in connection with other statutory or regulatory filings, including professional services in connection with the review of our regulatory filings for our follow-on offering of common units in June 2008. Audit fees also include fees of \$418,100 related to the restatement of our historical results for the five years ended December 31, 2007 and \$90,400 related to additional fees for the 2007 audit, which were not agreed until after we had filed our 2007 Annual Report on Form 20-F with the SEC on April 11, 2008.

(2) For 2008 and 2007, respectively, tax fees principally included corporate tax compliance fees of \$3,400 and \$15,800.

The Audit Committee of our general partner's Board of Directors has the authority to pre-approve permissible audit-related and non-audit services not prohibited by law to be performed by our independent auditors and associated fees. Engagements for proposed services either may be separately pre-approved by the Audit Committee or entered into pursuant to detailed pre-approval policies and procedures established by the Audit Committee, as long as the Audit Committee is informed on a timely basis of any engagement entered into on that basis. The Audit Committee separately pre-approved all engagements and fees paid to our principal accountant in 2008.

Item 16D. Exemptions from the Listing Standards for Audit Committees

Not applicable.

Item 16E. Purchases of Units by the Issuer and Affiliated Purchasers

Not applicable.

PART III

Item 17. Financial Statements

Not applicable.

Item 18. Financial Statements

The following financial statements, together with the related reports of Ernst & Young LLP, Independent Registered Public Accounting Firm thereon, are filed as part of this Annual Report:

	<u>Page</u>
Reports of Independent Registered Public Accounting Firm	F-1, F-2
Consolidated Financial Statements	
Consolidated Statements of Income (Loss)	F-3
Consolidated Balance Sheets	F-4
Consolidated Statements of Cash Flows	F-5
Consolidated Statements of Changes in Partners' Equity/Owner's Equity	F-6
Notes to the Consolidated Financial Statements	F-9

All schedules for which provision is made in the applicable accounting regulations of the SEC are not required, are inapplicable or have been disclosed in the Notes to the Consolidated Financial Statements and therefore have been omitted.

Item 19. Exhibits

The following exhibits are filed as part of this Annual Report:

- 1.1 Certificate of Limited Partnership of Teekay Offshore Partners L.P. (1)
 - 1.2 First Amended and Restated Agreement of Limited Partnership of Teekay Offshore Partners L.P. (2)
 - 1.3 Certificate of Formation of Teekay Offshore GP L.L.C. (1)
 - 1.4 Amended and Restated Limited Liability Company Agreement of Teekay Offshore GP L.L.C. (1)
 - 1.5 Certificate of Limited Partnership of Teekay Offshore Operating L.P. (1)
 - 1.6 Amended and Restated Agreement of Limited Partnership of Teekay Offshore Operating Partners L.P. (1)
 - 1.7 Certificate of Formation of Teekay Offshore Operating GP L.L.C. (1)
 - 1.8 Amended and Restated Limited Liability Company Agreement of Teekay Offshore Operating GP L.L.C. (1)
 - 4.1 Agreement, dated June 26, 2003, for a U.S \$455,000,000 Revolving Credit Facility between Norsk Teekay Holdings Ltd., Den Norske Bank ASA and various other banks (1)
 - 4.2 Agreement, dated October 2, 2006, for a U.S \$940,000,000 Revolving Credit Facility between Teekay Offshore Operating L.P., Den Norske Bank ASA and various other banks (1)
 - 4.3 Teekay Offshore Partners L.P. 2006 Long-Term Incentive Plan (1)
 - 4.4 Amended and Restated Omnibus Agreement (1)
 - 4.5 Administrative Services Agreement between Teekay Offshore Operating Partners L.P. and Teekay Limited (3)
 - 4.6 Advisory, Technical and Administrative Services Agreement between Teekay Offshore Operating Partners L.P. and Teekay Limited (3)
 - 4.7 Administrative Services Agreement between Teekay Offshore Partners L.P. and Teekay Limited (3)
 - 8.1 List of Subsidiaries of Teekay Offshore Partners L.P.
 - 12.1 Rule 13a-14(a)/15d-14(a) Certification of Teekay Offshore Partners L.P.'s Chief Executive Officer
 - 12.2 Rule 13a-14(a)/15d-14(a) Certification of Teekay Offshore Partners L.P.'s Chief Financial Officer
 - 13.1 Teekay Offshore Partners L.P. Certification of Peter Evensen, Chief Executive Officer and Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
 - 15.1 Consent of Ernst & Young LLP, as independent registered public accounting firm.
 - 15.2 Consolidated Balance Sheet of Teekay Offshore GP L.L.C.
- (1) Previously filed as an exhibit to the Partnership's Registration Statement on Form F-1 (File No. 333-139116), filed with the SEC on December 4, 2006, and hereby incorporated by reference to such Registration Statement.
- (2) Previously filed as Appendix A to the Partnership's Rule 424(b)(4) Prospectus filed with the SEC on December 14, 2006, and hereby incorporated by reference to such Prospectus.
- (3) Previously filed as an exhibit to the Partnership's Amendment No. 1 to Registration Statement on Form F-1 (File No. 333-139116), filed with the SEC on December 8, 2006, and hereby incorporated by reference to such Registration Statement.

SIGNATURE

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

TEEKAY OFFSHORE PARTNERS L.P.

By: Teekay Offshore GP L.L.C., its general partner

Dated: June 26, 2009

By: /s/ Peter Evensen

Peter Evensen

Chief Executive Officer and Chief Financial Officer
(Principal Financial and Accounting Officer)

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors of Teekay Offshore GP L.L.C.,
General Partner of Teekay Offshore Partners L.P.,
and the Limited Partners of Teekay Offshore Partners L.P.

We have audited the accompanying consolidated balance sheets of **Teekay Offshore Partners L.P.** (successor to Teekay Offshore Partners Predecessor) **and subsidiaries** (or the *Partnership*) as of December 31, 2008 and 2007, and the related consolidated statements of income (loss), partner's equity/owner's equity and cash flows for each of the three years in the period ended December 31, 2008, 2007 and 2006 aggregated as follows:

Year Ended December 31, 2008

- January 1 to December 31, 2008

Year Ended December 31, 2007

- January 1 to December 31, 2007

Year Ended December 31, 2006

- January 1 to December 18, 2006
- December 19 to December 31, 2006

These financial statements are the responsibility of the Partnership's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Teekay Offshore Partners L.P. and subsidiaries at December 31, 2008 and 2007, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2008 in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the consolidated financial statements, on January 1, 2007, the Partnership adopted the provisions of Financial Accounting Standards Board (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109*.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Teekay Offshore Partners L.P.'s internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated June 24, 2009 expressed an unqualified opinion thereon.

Vancouver, Canada
June 24, 2009

/s/ Ernst & Young LLP
Chartered Accountants

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors of Teekay Offshore GP L.L.C.,
General Partner of Teekay Offshore Partner L.P.,
and the Limited Partners of Teekay Offshore Partners L.P.

We have audited Teekay Offshore Partners L.P.'s (or the *Partnership's*) internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (or the *COSO criteria*). Teekay Offshore Partners L.P.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in Management's Report on Internal Control over Financial Reporting in the accompanying Form 20-F. Our responsibility is to express an opinion on the Partnership's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Partnership are being made only in accordance with authorizations of management and directors of the Partnership; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Partnership's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion Teekay Offshore Partners L.P. has maintained in all material respects effective internal control over financial reporting as of December 31, 2008 based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the 2008 consolidated financial statements of Teekay Offshore Partners L.P. and our report dated June 24, 2009 expressed an unqualified opinion thereon.

Vancouver, Canada
June 24, 2009,

/s/ Ernst & Young LLP
Chartered Accountants

TEEKAY OFFSHORE PARTNERS L.P. AND SUBSIDIARIES (Note 1)
(Successor to Teekay Offshore Partners Predecessor)
CONSOLIDATED STATEMENTS OF INCOME (LOSS)
(in thousands of U.S. dollars, except unit and per unit data)

	Year Ended December 31, 2008 \$	Year Ended December 31, 2007 \$	January 1 to December 18, 2006 \$	December 19 to December 31, 2006 \$
VOYAGE REVENUES (\$190,536, \$154,605, and \$74,651 for 2008, 2007, and 2006, respectively, from related parties – notes 10a, 10f, 10g, 10h, 10i, 10w, and 10aa)	872,492	785,203	617,514	24,397
OPERATING EXPENSES				
Voyage expenses	225,029	151,637	91,321	3,102
Vessel operating expenses (including (\$1,445) and (\$4,800) from related parties for 2008 and 2007 respectively - notes 10r, 10t and 10x, note 11)	184,416	149,660	107,991	4,297
Time-charter hire expense	132,234	150,463	159,973	5,641
Depreciation and amortization	138,437	124,370	100,823	3,726
General and administrative (\$51,314, \$55,543, and \$28,102 for 2008, 2007 and 2006, respectively, from related parties – notes 10j, 10k, 10l, and 10m, note 11)	64,230	62,404	63,014	2,177
Gain on sale of vessels and equipment - net of writedowns (note 15)	-	-	(4,778)	-
Restructuring charge (note 9)	-	-	832	-
Total operating expenses	744,346	638,534	519,176	18,943
Income from vessel operations	128,146	146,669	98,338	5,454
OTHER ITEMS				
Interest expense (note 6, includes \$132,617, \$44,523 and \$(3,346) for 2008, 2007 and 2006, respectively, in unrealized losses (gains) related to interest rate swaps - note 11, and \$1,236 and \$27,056 for 2007 and 2006, respectively, from related parties – notes 10d, 10e, and 10z)	(215,727)	(126,304)	(64,462)	(1,617)
Interest income	4,086	5,871	5,167	191
Equity income from joint ventures	-	-	6,321	-
Foreign currency exchange gain (loss) (note 11)	4,343	(11,678)	(66,214)	(118)
Other income - net (note 9)	11,936	10,403	8,367	309
Total other items	(195,362)	(121,708)	(110,821)	(1,235)
(Loss) income from continuing operations before non-controlling interest and income tax recovery (expense)	(67,216)	24,961	(12,483)	4,219
Income tax recovery (expense) (note 12)	56,704	10,516	(3,260)	(121)
(Loss) income from continuing operations before non-controlling interest	(10,512)	35,477	(15,743)	4,098
Non-controlling interest	(7,122)	(31,519)	(3,893)	(2,636)
Net (loss) income from continuing operations	(17,634)	3,958	(19,636)	1,462
Net loss from discontinued operations (note 18)	-	-	(10,656)	-
Net (loss) income	(17,634)	3,958	(30,292)	1,462
Dropdown predecessor's interest in net income (note 1)	1,333	1,300	3,097	114
General partner's interest in net income	8,918	733	-	64
Limited partners' interest: (note 16)				
Net (loss) income from continuing operations	(27,885)	1,925	(22,733)	1,284
Net (loss) income from continuing operations per:				
- Common unit (basic and diluted)	(0.90)	0.12	(1.80)	0.07
- Subordinated unit (basic and diluted)	(0.90)	0.07	(1.80)	0.06
- Total unit (basic and diluted)	(0.90)	0.10	(1.80)	0.07
Net loss from discontinued operations	-	-	(10,656)	-
Net loss from discontinued operations per:				
- Common unit (basic and diluted)	-	-	(0.85)	-
- Subordinated unit (basic and diluted)	-	-	(0.85)	-
- Total unit (basic and diluted)	-	-	(0.85)	-
Net (loss) income	(27,885)	1,925	(33,389)	1,284
Net (loss) income per:				
- Common unit (basic and diluted)	(0.90)	0.12	(2.65)	0.07
- Subordinated unit (basic and diluted)	(0.90)	0.07	(2.65)	0.06
- Total unit (basic and diluted)	(0.90)	0.10	(2.65)	0.07
Weighted average number of units outstanding:				
- Common units (basic and diluted)	15,461,202	9,800,000	2,800,000	9,800,000
- Subordinated units (basic and diluted)	9,800,000	9,800,000	9,800,000	9,800,000
- Total units (basic and diluted)	25,261,202	19,600,000	12,600,000	19,600,000
Cash distributions declared per unit	1.65	1.14	-	-

The accompanying notes are an integral part of the consolidated financial statements.

TEEKAY OFFSHORE PARTNERS L.P. AND SUBSIDIARIES (Note 1)
(Successor to Teekay Offshore Partners Predecessor)
CONSOLIDATED BALANCE SHEETS
(in thousands of U.S. dollars)

	As at December 31, 2008 \$	As at December 31, 2007 \$
ASSETS		
Current		
Cash and cash equivalents <i>(note 6)</i>	131,488	121,224
Accounts receivable	39,500	42,245
Net investment in direct financing leases - current <i>(note 7)</i>	22,941	22,268
Prepaid expenses	25,334	34,219
Due from affiliates <i>(note 10y)</i>	10,110	18,350
Other current assets	2,585	7,644
Total current assets	231,958	245,950
Vessels and equipment <i>(note 6)</i>		
At cost, less accumulated depreciation of \$793,918 (December 31, 2007 - \$694,258)	1,708,006	1,662,865
Net investment in direct financing leases <i>(note 7)</i>	55,710	78,199
Other assets	12,015	14,423
Intangible assets – net <i>(note 4)</i>	45,290	55,355
Goodwill - shuttle tanker segment	127,113	127,113
Total assets	2,180,092	2,183,905
LIABILITIES AND PARTNERS' EQUITY		
Current		
Accounts payable	9,901	12,076
Accrued liabilities <i>(note 5)</i>	44,467	38,464
Due to affiliate <i>(note 10y)</i>	8,715	17,554
Current portion of derivative instruments <i>(note 11)</i>	54,937	5,277
Current portion of long-term debt <i>(note 6)</i>	125,503	64,060
Due to joint venture partners	21,019	3,534
Total current liabilities	264,542	140,965
Long-term debt <i>(note 6)</i>	1,440,933	1,453,407
Deferred income tax <i>(note 12)</i>	12,648	77,306
Derivative instruments <i>(note 11)</i>	138,374	17,770
Other long-term liabilities	21,346	24,443
Total liabilities	1,877,843	1,713,891
Commitments and contingencies <i>(notes 6, 7, 11 and 13)</i>		
Non-controlling interest	201,383	392,613
Partners' equity		
Partners' equity	117,910	77,108
Accumulated other comprehensive (loss) income	(17,044)	293
Total partners' equity	100,866	77,401
Total liabilities and partners' equity	2,180,092	2,183,905

The accompanying notes are an integral part of the consolidated financial statements.

TEEKAY OFFSHORE PARTNERS L.P. AND SUBSIDIARIES (Note 1)
(Successor to Teekay Offshore Partners Predecessor)
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands of U.S. dollars)

	Year Ended December 31, 2008 \$	Year Ended December 31, 2007 \$	Year Ended December 31, 2006 \$
Cash and cash equivalents provided by (used for)			
OPERATING ACTIVITIES			
Net (loss) income	(17,634)	3,958	(28,830)
Non-cash items:			
Unrealized loss (gain) on derivative instruments <i>(note 11)</i>	130,482	45,957	(3,346)
Depreciation and amortization	138,437	124,370	104,549
Non-controlling interest	7,122	31,519	6,529
Gain on sale of vessels	-	-	(6,928)
Loss on writedown of vessels and equipment	-	-	2,150
Equity income (net of dividends received: December 31, 2006 - \$6,002)	-	-	(319)
Income tax (recovery) expense	(56,704)	(10,516)	425
Foreign currency exchange (gain) loss and other	(1,029)	11,425	72,438
Change in non-cash working capital items related to operating activities <i>(note 14)</i>	22,943	(33,706)	51,039
Distribution from subsidiaries to non-controlling interest owners	(71,976)	(78,107)	(4,224)
Expenditures for drydocking	(29,075)	(49,053)	(31,255)
Net operating cash flow	122,566	45,847	162,228
FINANCING ACTIVITIES			
Proceeds from issuance of long-term debt	191,000	298,443	1,290,750
Debt issuance costs	(1,500)	-	(6,178)
Scheduled repayments of long-term debt	(68,031)	(17,328)	(119,900)
Prepayments of long-term debt	(119,000)	(152,000)	(493,527)
Repayments of capital lease obligations	-	-	(34,245)
Net advances to affiliates	(46,544)	(42,935)	(793,488)
Net advances from joint venture partners	17,485	-	-
Equity contribution from joint venture partner	5,200	-	-
Equity distribution from (to) Teekay Corporation	-	1,819	(230,886)
Proceeds from issuance of common units <i>(note 2)</i>	216,837	-	157,963
Expenses from issuance of common units	(6,192)	(2,793)	-
Distribution to Teekay Corporation relating to purchase of SPT Explorer L.L.C. and SPT Navigator L.L.C. <i>(note 10w)</i>	(16,661)	-	-
Distribution to Teekay Corporation relating to purchase of Dampier LLC <i>(note 10p)</i>	-	(30,253)	-
Excess purchase price over the contributed basis of a 25% interest in Teekay Offshore Operating L.P. <i>(note 10v)</i>	(91,562)	-	-
Distribution to Teekay Corporation relating to purchase of Navion Bergen L.L.C. <i>(note 10o)</i>	-	(48,800)	-
Excess of purchase price over the contributed basis of a 50% interest in Navion Gothenburg L.L.C. <i>(note 10o)</i>	-	(6,358)	-
Cash distributions paid	(42,226)	(22,700)	-
Other	-	(1,000)	(727)
Net financing cash flow	38,806	(23,905)	(230,238)
INVESTING ACTIVITIES			
Expenditures for vessels and equipment	(57,858)	(20,997)	(31,079)
Proceeds from sale of vessels and equipment	-	3,225	61,713
Investment in direct financing lease assets	(536)	(8,378)	(13,256)
Direct financing lease payments received	22,352	21,677	19,323
Purchase of a 25% interest in Teekay Offshore Operating L.P. <i>(note 10v)</i>	(115,066)	-	-
Cash assumed upon consolidation of 50%-owned subsidiaries	-	-	17,055
Purchase of a 50% interest in Navion Gothenburg L.L.C. <i>(note 10o)</i>	-	(10,231)	-
Other	-	-	(746)
Net investing cash flow	(151,108)	(14,704)	53,010
Increase (decrease) in cash and cash equivalents	10,264	7,238	(15,000)
Adjustment for net change in cash and cash equivalents in discontinued operations	-	-	2,456
Cash and cash equivalents, beginning of the year	121,224	113,986	126,530
Cash and cash equivalents, end of the year	131,488	121,224	113,986

Supplemental cash flow disclosure *(note 14)*

The accompanying notes are an integral part of the consolidated financial statements.

TEEKAY OFFSHORE PARTNERS L.P. AND SUBSIDIARIES (Note 1)
(Successor to Teekay Offshore Partners Predecessor)
CONSOLIDATED STATEMENTS OF CHANGES IN PARTNERS' EQUITY/OWNER'S EQUITY
(in thousands of U.S. dollars and units)

	Owner's Equity	Accumulated Other Comprehensive Income (Loss)	Total Owner's Equity
	\$	\$	\$
Balance as at December 31, 2005	795,663	-	795,663
Net loss and comprehensive loss (January 1 to December 18, 2006)	(30,292)	-	(30,292)
Net change in parent's equity in Dropdown Predecessor	798	-	798
Gain on sale of Navion Shipping Ltd. to Teekay Corporation (<i>notes 10a and 18</i>)	18,468	-	18,468
Gain on sale of Norwegian subsidiaries to Teekay Corporation (<i>note 10c</i>)	23,260	-	23,260
Loss on sale of the <i>Borga</i> to Teekay Corporation (<i>note 10b</i>)	(11,900)	-	(11,900)
Stock compensation expense (<i>note 1</i>)	1,048	-	1,048
Excess purchase price over the contributed basis of Teekay Offshore Partners Predecessor (<i>note 1</i>)	(231,684)	-	(231,684)
Purchase of a 26% interest in Teekay Offshore Operating L.P. from Teekay Corporation (<i>note 1</i>)	(134,629)	-	(134,629)
Reclassification adjustment for Teekay Corporation's 74% non-controlling interest in Teekay Offshore Operating L.P. (<i>note 1</i>)	(376,089)	-	(376,089)
Balance as at December 18, 2006	54,643	-	54,643

The accompanying notes are an integral part of the consolidated financial statements.

TEEKAY OFFSHORE PARTNERS L.P. AND SUBSIDIARIES (Note 1)
(Successor to Teekay Offshore Partners Predecessor)
CONSOLIDATED STATEMENTS OF CHANGES IN PARTNERS' EQUITY/OWNER'S EQUITY
(in thousands of U.S. dollars and units)

	PARTNERS' EQUITY							Accumulated Other Comprehensive Income (Loss)	Total	
	Owner's Equity (Predecessor and Dropdown Predecessor)	Limited Partners				General Partner				
		Common		Subordinated						
		Units	\$	Units	\$		\$	\$		
Balance as at December 18, 2006	54,643						-	54,643		
Net income and comprehensive income (December 19 – 31, 2006)	114	-	678	-	606	64	-	1,462		
Allocation of Predecessor and Dropdown Predecessor's equity to unitholders (note 1)	(2,965)	2,800	634	9,800	2,220	111	-	-		
Proceeds from initial public offering of limited partnership interests, net of offering costs of \$13,788 (note 2)	-	8,050	155,262	-	-	-	-	155,262		
Redemption of common units from Teekay Corporation (note 2)	-	(1,050)	(20,633)	-	-	-	-	(20,633)		
Balance as at December 31, 2006	51,792	9,800	135,941	9,800	2,826	175	-	190,734		
Net income (January 1 – December 31, 2007)	1,300	-	1,225	-	700	733	-	3,958		
Other comprehensive income:										
Unrealized net gain on qualifying cash flow hedging instruments (note 11)							281	281		
Realized net loss on qualifying cash flow hedging instruments (note 11)							12	12		
Comprehensive income								4,251		
Contribution of foreign currency forward contracts from Teekay Corporation (note 10s)			16		89	4		109		
Offering costs from public offering of limited partnership interests			(93)					(93)		
Net change in parent's equity in Dropdown Predecessor (note 14e)	(6,939)							(6,939)		
Purchase of Navion Bergen LLC and Navion Gothenburg LLC from Teekay Corporation (note 10o)	(29,756)		(3,720)		(20,832)	(850)		(55,158)		
Purchase of Dampier Spirit LLC from Teekay Corporation (note 10p)	(16,397)		(2,029)		(11,363)	(464)		(30,253)		
Contribution of interest rate swap agreement from Teekay Corporation (note 10q)			(373)		(2,092)	(85)		(2,550)		
Cash distributions			(11,123)		(11,123)	(454)		(22,700)		
Balance as at December 31, 2007	-	9,800	119,844	9,800	(41,795)	(941)	293	77,401		

The accompanying notes are an integral part of the consolidated financial statements.

TEEKAY OFFSHORE PARTNERS L.P. AND SUBSIDIARIES (Note 1)
(Successor to Teekay Offshore Partners Predecessor)
CONSOLIDATED STATEMENTS OF CHANGES IN PARTNERS' EQUITY/OWNER'S EQUITY
(in thousands of U.S. dollars and units)

	PARTNERS' EQUITY							Total
	Owner's Equity (Dropdown Predecessor)	Limited Partners				General Partner	Accumulated Other Comprehensive Income (Loss)	
		Common		Subordinated				
		Units	\$	Units	\$			
Balance as at December 31, 2007	-	9,800	119,844	9,800	(41,795)	(941)	293	77,401
Net loss (January 1 – December 31, 2008)	1,333		(19,049)		(8,836)	8,918		(17,634)
Unrealized net loss on qualifying cash flow hedging instruments <i>(note 11)</i>							(20,209)	(20,209)
Realized net gain on qualifying cash flow hedging instruments <i>(note 11)</i>							1,906	1,906
Comprehensive loss								<u>(35,937)</u>
Purchase of a 25% interest in Teekay Offshore Operating L.P. from Teekay Corporation <i>(note 10v)</i>			(30,025)		(58,846)	(3,657)	966	(91,562)
Proceeds from follow-on public offering and private placement of limited partnership interests, net of offering costs of \$6,192 <i>(note 2)</i>		10,625	206,308			4,337		210,645
Purchase of SPT Explorer L.L.C. and SPT Navigator L.L.C. from Teekay Corporation <i>(note 10w)</i>	(1,333)		(5,231)		(10,253)	(638)		(17,455)
Cash distributions			(25,201)		(16,170)	(855)		(42,226)
Balance as at December 31, 2008	-	20,425	246,646	9,800	(135,900)	7,164	(17,044)	100,866

The accompanying notes are an integral part of the consolidated financial statements.

TEEKAY OFFSHORE PARTNERS L.P. AND SUBSIDIARIES
(Successor to Teekay Offshore Partners Predecessor)
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(all tabular amounts stated in thousands of U.S. dollars, except unit and per unit data or unless otherwise indicated)

1. Summary of Significant Accounting Policies

Basis of presentation

During August 2006, Teekay Corporation formed Teekay Offshore Partners L.P., a Marshall Islands limited partnership (the *Partnership*), as part of its strategy to expand in the marine transportation, processing and storage sectors of the offshore oil industry and for the Partnership to acquire, in connection with the Partnership's initial public offering of its common units, a 26.0% interest in Teekay Offshore Operating L.P. (or *OPCO*), consisting of a 25.99% limited partner interest to be held directly by the Partnership and a 0.01% general partner interest to be held through the Partnership's ownership of Teekay Offshore Operating GP L.L.C., *OPCO's* sole general partner.

Prior to the closing of the Partnership's initial public offering on December 19, 2006, Teekay Corporation transferred eight Aframax conventional crude oil tankers to a subsidiary of Norsk Teekay Holdings Ltd. (or *Norsk Teekay*) and one floating storage and offtake (or *FSO*) unit to Teekay Offshore Australia Trust. Teekay Corporation then transferred to *OPCO* all of the outstanding interests of four wholly-owned subsidiaries — Norsk Teekay, Teekay Nordic Holdings Inc., Teekay Offshore Australia Trust and Pattani Spirit L.L.C. These four wholly-owned subsidiaries, the assets of which include the eight Aframax conventional crude oil tankers and the *FSO* unit, are collectively referred to as *Teekay Offshore Partners Predecessor* or the *Predecessor*. The excess of the price paid by the Partnership over the book value of these assets was \$231.7 million and was accounted for as an equity distribution to Teekay Corporation. Immediately prior to the closing of the Partnership's initial public offering, Teekay Corporation sold to the Partnership the 25.99% limited partner interest in *OPCO* and its subsidiaries and a 100% interest in Teekay Offshore Operating GP L.L.C., which owns the 0.01% general partner interest in *OPCO*, in exchange for (a) the issuance to Teekay Corporation of 2,800,000 common units and 9,800,000 subordinated units of the Partnership and a \$134.6 million non-interest bearing promissory note and (b) the issuance of the 2.0% general partner interest in the Partnership and all of the Partnership's incentive distribution rights to Teekay Offshore GP L.L.C., a wholly owned subsidiary of Teekay Corporation (or *the General Partner*). The Partnership controls *OPCO* through its ownership of *OPCO's* general partner and Teekay Corporation initially owned the remaining 74.0% interest in *OPCO*. These transfers represented a reorganization of entities under common control and were recorded at historical cost. Immediately preceding the public offering, the net book equity of the Partnership's 26% share of these assets was \$3.5 million. In June 2008, the Partnership purchased from Teekay Corporation an additional 25.0% limited partner interest in *OPCO*. Teekay Corporation currently owns the remaining 49.0% interest in *OPCO*.

As required by Statement of Financial Accounting Standards (or *SFAS*) No. 141, Business Combinations, the Partnership accounts for the acquisition of interests in vessels from Teekay Corporation as a transfer of a business between entities under common control. The method of accounting prescribed by *SFAS* No. 141 for such transfers is similar to pooling of interests method of accounting. Under this method, the carrying amount of net assets recognized in the balance sheets of each combining entity is carried forward to the balance sheet of the combined entity, and no other assets or liabilities are recognized as a result of the combination. The excess of the proceeds paid, if any, by the Partnership over Teekay Corporation's historical cost is accounted for as an equity distribution to Teekay Corporation. In addition, transfers of net assets between entities under common control are accounted for as if the transfer occurred from the date that the Partnership and the acquired vessels were both under common control of Teekay Corporation and had begun operations. As a result, the Partnership's financial statements prior to the date the interests in these vessels were actually acquired by the Partnership are retroactively adjusted to include the results of these vessels operated during the periods under common control of Teekay Corporation.

In July 2007, the Partnership acquired from Teekay Corporation ownership of its 100% interest in the 2000-built shuttle tanker *Navion Bergen* and its 50% interest in the 2006-built shuttle tanker *Navion Gothenburg*, respectively. The acquisitions included the assumption of debt, related interest rate swap agreements and Teekay Corporation's rights and obligations under 13-year, fixed-rate bareboat charters. In October 2007, the Partnership acquired from Teekay Corporation its interest in the *FSO* unit *Dampier Spirit*, along with its 7-year fixed-rate time-charter. In June 2008, the Partnership acquired from Teekay Corporation its interest in two 2008- built Aframax lightering tankers, the *SPT Explorer* and the *SPT Navigator*. The acquisition included the assumption of debt and Teekay Corporation's rights and obligations under 10-year, fixed-rate bareboat charters (with options exercisable by the charterer to extend up to an additional five years). All of these transactions were deemed to be business acquisitions between entities under common control. As a result, the Partnership's statement of income (loss) for the years ended December 31, 2008, 2007 and 2006, the Partnership's statement of cash flows for the years ended December 31, 2008, 2007 and 2006, and the Partnership's statement of changes in partners' equity and balance sheets for the years ended December 31, 2008, 2007 and 2006 have been retroactively adjusted to include the results of these acquired vessels (referred to herein as the *Dropdown Predecessor*), from the date that the Partnership and acquired vessels were both under common control of Teekay Corporation and had begun operations. These vessels began operations on April 16, 2007 (*Navion Bergen*), July 24, 2007 (*Navion Gothenburg*), March 15, 1998 (*Dampier Spirit*), January 7, 2008 (*SPT Explorer*) and March 28, 2008 (*SPT Navigator*). The effect of adjusting the Partnership's financial statements to account for these common control transfers increased the Partnership's net income by \$1.3 million, \$1.3 million and \$3.2 million for the years ended December 31, 2008, 2007 and 2006.

The consolidated financial statements reflect the combined consolidated financial position, results of operations and cash flows of the Predecessor and its subsidiaries, including, as applicable, the *Dropdown Predecessor*. In the preparation of these consolidated financial statements, general and administrative expenses and interest expense were not identifiable as relating solely to each specific vessel. General and administrative expenses (consisting primarily of salaries and other employee related costs, office rent, legal and professional fees, and travel and entertainment) were allocated based on the Predecessor's or *Dropdown Predecessor's* proportionate share of Teekay Corporation's total ship-operating (calendar) days for each of the periods presented. In addition, to the extent the Predecessor and *Dropdown Predecessor* were capitalized with non-interest bearing loans from Teekay Corporation and its subsidiaries, these intercompany loans were generally used to finance the acquisition of the vessels. Interest expense includes the allocation of interest to the Predecessor and the *Dropdown Predecessor* from Teekay Corporation and its subsidiaries based upon the weighted-average outstanding balance of these intercompany loans and the weighted-average interest rate outstanding on Teekay Corporation's loan facilities that were used to finance these intercompany loans. Management believes these allocations reasonably present the general and administrative expenses and interest expense of the Predecessor and the *Dropdown Predecessor*.

TEEKAY OFFSHORE PARTNERS L.P. AND SUBSIDIARIES
(Successor to Teekay Offshore Partners Predecessor) – (Cont'd)
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(all tabular amounts stated in thousands of U.S. dollars, except unit and per unit data or unless otherwise indicated)

The consolidated financial statements have been prepared in conformity with United States generally accepted accounting principles (or GAAP). They include the accounts of the Predecessor and its subsidiaries and, as applicable, the Dropdown Predecessor for periods prior to December 19, 2006. For the periods commencing December 19, 2006, the consolidated financial statements include the accounts of Teekay Offshore Partners L.P. and its subsidiaries and, as applicable, the Dropdown Predecessor. In addition, the consolidated financial statements include the accounts of the Predecessor's and the Partnership's 50% owned subsidiaries from December 1, 2006, when the Partnership gained control of these subsidiaries. Significant intercompany balances and transactions have been eliminated upon consolidation.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results may differ from those estimates.

Certain of the comparative figures have been reclassified to conform with the presentation adopted in the current period.

Reporting currency

The consolidated financial statements are stated in U.S. dollars. The functional currency of the Partnership is U.S. dollars because most of the Partnership's shipping revenues currently are earned in U.S. Dollars. Transactions involving other currencies during the year are converted into U.S. dollars using the exchange rates in effect at the time of the transactions. At the balance sheet dates, monetary assets and liabilities that are denominated in currencies other than the U.S. dollar are translated to reflect the year-end exchange rates. Resulting gains or losses are reflected separately in the accompanying consolidated statements of income (loss).

Operating revenues and expenses

The Partnership recognizes revenues from time charters and bareboat charters daily over the term of the charter as the applicable vessel operates under the charter. The Partnership does not recognize revenue during days that the vessel is off-hire. Shuttle tanker voyages servicing contracts of affreightment with offshore oil fields commence with tendering of notice of readiness at a field, within the agreed lifting range, and ends with tendering of notice of readiness at a field for the next lifting. All other voyage revenues from voyage charters are recognized on a percentage of completion method. The Partnership uses a discharge-to-discharge basis in determining percentage of completion for all spot voyages, whereby it recognizes revenue ratably from when product is discharged (unloaded) at the end of one voyage to when it is discharged after the next voyage. The Partnership does not begin recognizing voyage revenue until a charter has been agreed to by the customer and the Partnership, even if the vessel has discharged its cargo and is sailing to the anticipated load port on its next voyage. The consolidated balance sheets reflect the deferred portion of revenues and expenses, which will be earned and incurred, respectively, in subsequent periods. As at December 31, 2008 and 2007, there was no deferred revenue. As at December 31, 2008 and 2007, the deferred portion of expenses, which are included in prepaid expenses, was \$14.4 million and \$25.4 million, respectively.

Voyage expenses are all expenses unique to a particular voyage, including bunker fuel expenses, port fees, cargo loading and unloading expenses, canal tolls, agency fees and commissions. Vessel operating expenses include crewing, repairs and maintenance, insurance, stores, lube oils and communication expenses. Voyage expenses and vessel operating expenses are recognized when incurred. For periods prior to October 1, 2006, the Predecessor recognized voyage expenses ratably over the length of each voyage. The impact of recognizing voyage expenses ratably over the length of each voyage was not materially different on a quarterly and annual basis from a method of recognizing such costs as incurred.

Cash and cash equivalents

The Partnership classifies all highly liquid investments with an original maturity date of three months or less when purchased as cash and cash equivalents.

Accounts receivable and allowance for doubtful accounts

Accounts receivable are recorded at the invoiced amount and do not bear interest. The allowance for doubtful accounts is the Partnership's best estimate of the amount of probable credit losses in existing accounts receivable. The Partnership determines the allowance based on historical write-off experience and customer economic data. The Partnership reviews the allowance for doubtful accounts regularly and past due balances are reviewed for collectability. Account balances are charged off against the allowance when the Partnership believes that the receivable will not be recovered.

Vessels and equipment

All pre-delivery costs incurred during the construction of newbuildings, including interest, supervision and technical costs, are capitalized. The acquisition cost and all costs incurred to restore used vessels purchased by the Partnership to the standards required to properly service the Partnership's customers are capitalized.

TEEKAY OFFSHORE PARTNERS L.P. AND SUBSIDIARIES
(Successor to Teekay Offshore Partners Predecessor)
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS- (Cont'd)
(all tabular amounts stated in thousands of U.S. dollars, except unit and per unit data or unless otherwise indicated)

Depreciation is calculated on a straight-line basis over a vessel's estimated useful life, less an estimated residual value. Depreciation is calculated using an estimated useful life of 25 years, commencing from the date the vessel is delivered from the shipyard, or a shorter period if regulations prevent the Partnership from operating the vessel for 25 years. Depreciation of vessels and equipment (including depreciation attributable to the Dropdown Predecessor) for the year ended December 31, 2008 and 2007, and for the periods from December 19, 2006 to December 31, 2006, and from January 1, 2006 to December 18, 2006, totalled \$106.1 million, \$98.5 million, \$2.9 million, and \$81.3 million, respectively. Depreciation and amortization includes depreciation on all owned vessels and amortization of vessels accounted for as capital leases.

Vessel capital modifications include the addition of new equipment or can encompass various modifications to the vessel which are aimed at improving and/or increasing the operational efficiency and functionality of the asset. This type of expenditure is amortized over the estimated useful life of the modification. Expenditures covering recurring routine repairs or maintenance are expensed as incurred.

Generally, the Partnership drydocks each shuttle tanker and conventional oil tanker every two and a half to five years. FSO units are generally not drydocked. The Partnership capitalizes a substantial portion of the costs incurred during drydocking and amortizes those costs on a straight-line basis from the completion of a drydocking to the estimated completion of the next drydocking. The Partnership includes in capitalized drydocking those costs incurred as part of the drydocking to meet regulatory requirements, or are expenditures that either add economic life to the vessel, increase the vessel's earnings capacity or improve the vessel's efficiency. The Partnership expenses as incurred costs related to routine repairs and maintenance performed during drydocking that do not improve or extend the useful lives of the assets. When significant drydocking expenditures occur prior to the expiration of the original amortization period, the remaining unamortized balance of the original drydocking cost are expensed in the month of the subsequent drydocking. Amortization of drydocking expenditures (including amortization attributable to the Dropdown Predecessor) for the year ended December 31, 2008 and 2007, and for the periods from December 19, 2006 to December 31, 2006, January 1, 2006 to December 18, 2006, totalled \$22.2 million, \$14.8 million, \$0.3 million, and \$7.8 million, respectively.

Drydocking activity for the three years ended December 31, 2008 is summarized as follows:

	Year Ended December 31, 2008 \$	Year Ended December 31, 2007 \$	Year Ended December 31, 2006	
			December 19 to December 31, 2006 \$	January 1 to December 18, 2006 \$
Balance at beginning of period	71,910	39,875	40,179	21,856
Cost incurred for drydocking	26,944	37,243	-	31,339
Drydock amortization	(22,235)	(14,812)	(304)	(7,845)
Vessel sale	-	-	-	(5,171)
Amounts acquired from business acquisitions	-	9,604	-	-
Balance at end of period	76,619	71,910	39,875	40,179

Vessels and equipment that are "held and used" are assessed for impairment when events or circumstances indicate the carrying amount of the asset may not be recoverable. If the asset's net carrying value exceeds the net undiscounted cash flows expected to be generated over its remaining useful life, the carrying amount of the asset is reduced to its estimated fair value. Estimated fair value is determined based on discounted cash flows or appraised values depending on the nature of the asset.

Direct financing leases

The Partnership assembles, installs, operates and leases equipment that reduces volatile organic compound emissions (or *VOC equipment*) during loading, transportation and storage of oil and oil products. Leasing of the VOC equipment is accounted for as a direct financing lease with lease payments received by the Partnership being allocated between the net investment in the lease and other income using the effective interest method so as to produce a constant periodic rate of return over the lease term.

Investment in joint ventures

Investments in companies over which the Partnership exercises significant influence, are accounted for using the equity method, whereby the investment is carried at the Partnership's original cost plus its proportionate share of undistributed earnings. The excess carrying value of the Partnership's investment over its underlying equity in the net assets is included in the consolidated balance sheet as investment in joint ventures.

On December 1, 2006, the operating agreements for the five 50%-owned joint ventures, each of which owns one shuttle tanker, were amended. These amendments resulted in the Partnership obtaining control of these entities and, consequently, the Partnership has consolidated these entities effective December 1, 2006. As at December 31, 2008, the Partnership had a 50% interest in six subsidiaries.

Debt issuance costs

Debt issuance costs, including fees, commissions and legal expenses, are presented as other assets and capitalized and amortized on a straight-line basis over the term of the relevant loan. Amortization of debt issuance costs is included in interest expense.

TEEKAY OFFSHORE PARTNERS L.P. AND SUBSIDIARIES
(Successor to Teekay Offshore Partners Predecessor)
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS- (Cont'd)
(all tabular amounts stated in thousands of U.S. dollars, except unit and per unit data or unless otherwise indicated)

Goodwill and intangible assets

Goodwill is not amortized, but reviewed for impairment annually or more frequently if impairment indicators arise. A fair value approach is used to identify potential goodwill impairment and, when necessary, measure the amount of impairment. The Partnership uses a discounted cash flow model to determine the fair value of reporting units, unless there is a readily determinable fair market value. Intangible assets are assessed for impairment when and if impairment indicators exist. An impairment loss is recognized if the carrying amount of an intangible asset is not recoverable and its carrying amount exceeds its fair value.

The Partnership's intangible assets, which consist of contracts of affreightment acquired as part of the Predecessor's purchase of Navion AS in 2003, are amortized over their respective lives, with the amount amortized each year being weighted based on the projected revenue to be earned under the contracts.

Derivative instruments

All derivative instruments are initially recorded at cost as either assets or liabilities in the accompanying consolidated balance sheets and subsequently remeasured to fair value, regardless of the purpose or intent for holding the derivative. The method of recognizing the resulting gain or loss is dependent on whether the derivative contract is designed to hedge a specific risk and also qualifies for hedge accounting. The Partnership generally does not designate its interest rate swap agreements as cash flow hedges for accounting purposes. The Partnership generally designates foreign currency forward contracts as cash flow hedges for accounting purposes. (Please see Note 11.)

When a derivative is designated as a cash flow hedge, the Partnership formally documents the relationship between the derivative and the hedged item. This documentation includes the strategy and risk management objective for undertaking the hedge and the method that will be used to assess the effectiveness of the hedge. Any hedge ineffectiveness is recognized immediately in earnings, as are any gains and losses on the derivative that are excluded from the assessment of hedge effectiveness. The Partnership does not apply hedge accounting if it is determined that the hedge was not effective or will no longer be effective, the derivative was sold or exercised, or the hedged item was sold, repaid or no longer possible of occurring.

For derivative financial instruments designated and qualifying as cash flow hedges, changes in the fair value of the effective portion of the derivative financial instruments are initially recorded as a component of accumulated other comprehensive income in partners' equity. In the periods when the hedged items affect earnings, the associated fair value changes on the hedging derivatives are transferred from partners' equity to the corresponding earnings line item. The ineffective portion of the change in fair value of the derivative financial instruments is immediately recognized in earnings. If a cash flow hedge is terminated and the originally hedged items may still possibly affect earnings, the gains and losses initially recognized in partners' equity remain until the hedged item impacts earnings, at which point they are transferred to the corresponding earnings line item. If the hedged items may no longer affect earnings, amounts recognized in partners' equity are immediately transferred to earnings.

For derivative financial instruments that are not designated or that do not qualify as hedges under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended, the changes in the fair value of the derivative financial instruments are recognized in earnings.

Gains and losses from the Partnership's non-designated interest rate swaps related to long-term debt are recorded in interest expense. Gains and losses from the Partnership's foreign currency forward contracts are recorded within operating expenses, based on the nature of the expense being hedged.

Income taxes

The Partnership's Norwegian subsidiaries and Australian subsidiary are subject to income taxes. The Partnership accounts for such taxes using the liability method pursuant to SFAS No. 109, *Accounting for Income Taxes*.

In July 2006, the Financial Accounting Standards Board (or *FASB*) issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109* (or *FIN 48*). This interpretation clarifies the accounting for uncertainty in income taxes recognized in financial statements in accordance with SFAS 109. FIN 48 requires companies to determine whether it is more-likely-than-not that a tax position taken or expected to be taken in a tax return will be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. If a tax position meets the more-likely-than-not recognition threshold, it is measured to determine the amount of benefit to recognize in the financial statements based on guidance in the interpretation.

The Partnership adopted FIN 48 as of January 1, 2007. The adoption of FIN 48 did not have a significant impact on the Partnership's financial position and results of operations. As of December 31, 2008 and 2007, the Partnership did not have any material unrecognized tax benefits or material accrued interest and penalties relating to taxes. The Partnership does not expect any material changes to its unrecognized tax positions within the next twelve months.

The Partnership recognizes interest and penalties related to uncertain tax positions in income tax expense. The 2006, 2007 and 2008 tax years remain open to examination by the Australian and Norwegian taxing jurisdictions to which the Partnership is subject.

TEEKAY OFFSHORE PARTNERS L.P. AND SUBSIDIARIES
(Successor to Teekay Offshore Partners Predecessor)
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS- (Cont'd)
(all tabular amounts stated in thousands of U.S. dollars, except unit and per unit data or unless otherwise indicated)

Accounting for stock-based compensation

Effective January 1, 2006, the Predecessor adopted the fair value recognition provisions of SFAS No. 123(R), *Share-Based Payment* (or SFAS 123(R)), using the "modified prospective" method. Under this transition method, compensation cost is recognized in the consolidated financial statements beginning with the effective date for all share-based payments granted after January 1, 2006 and for all awards granted to employees prior to, but not yet vested as of January 1, 2006. Accordingly, prior period amounts have not been restated.

Prior to January 1, 2006, the Predecessor accounted for stock options under APB No. 25, using the intrinsic value method, as permitted by SFAS No. 123, *Accounting for Stock-Based Compensation*. As the exercise price of the Predecessor's employee stock options equals the market price of underlying stock on the date of grant, no compensation expense was recognized under APB No. 25.

Certain employees of the Predecessor participate in the stock option plan of the Partnership's parent, Teekay Corporation. Stock options granted under this plan have a 10-year term and vest equally over three years from the grant date. As of December 31, 2008, all outstanding options expire between May 28, 2006 and March 7, 2016, ten years after the date of each respective grant.

During the fourth quarter of 2006, substantially all of the Predecessor's employees were transferred to subsidiaries of Teekay Corporation, and, subsequently, stock-based compensation has been allocated to the Partnership through a service agreement with a subsidiary of Teekay Corporation (Note 10(I)).

Recent Accounting Pronouncements

In April 2009, the Financial Accounting Standards Board (or FASB) issued Statement of Financial Accounting Standards (or SFAS) 115-2 and SFAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*. This statement changes existing accounting requirements for other-than-temporary impairment. SFAS 115-2 is effective for interim and annual periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. The Partnership is currently evaluating the potential impact, if any, of the adoption of SFAS 115-2 on its consolidated results of operations and financial condition.

In April 2009, the FASB issued SFAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability has Significantly Decreased and Identifying Transactions that are Not Orderly*. SFAS 157-4 amends SFAS 157, *Fair Value Measurements* to provide additional guidance on estimating fair value when the volume and level of transaction activity for an asset or liability have significantly decreased in relation to normal market activity for the asset or liability. SFAS 157-4 also provides additional guidance on circumstances that may indicate that a transaction is not orderly. SFAS 157-4 supersedes SFAS 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active*. The guidance in SFAS 157-4 is effective for interim and annual reporting periods ending after June 15, 2009. Early adoption is permitted, but only for periods ending after March 15, 2009. The Partnership is currently evaluating the potential impact, if any, of the adoption of SFAS 157-4 on its consolidated results of operations and financial condition.

In April 2009, the FASB issued SFAS 107-1 and APB 28-1, *Interim Disclosures About Fair Value of Financial Instruments*. SFAS 107-1 extends the disclosure requirements of SFAS 107, *Disclosures about Fair Value of Financial Instruments* to interim financial statements of publicly traded companies as defined in APB Opinion No. 28, *Interim Financial Reporting*. SFAS 107-1 is effective for interim reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. The Partnership is currently evaluating the potential impact, if any, of the adoption of SFAS 107-1 on its consolidated results of operations and financial condition.

In April 2009, the FASB issued SFAS 141(R)-1, *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination that Arise from Contingencies*. This statement amends SFAS 141, *Business Combinations*, to require that assets acquired and liabilities assumed in a business combination that arise from contingencies be recognized at fair value, in accordance with SFAS 157, if the fair value can be determined during the measurement period. SFAS 141(R)-1 is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Partnership is currently evaluating the potential impact, if any, of the adoption of SFAS 141(R)-1 on its consolidated results of operations and financial condition.

In October 2008, FASB issued SFAS No. 157-3, *Determining the Fair Value of a Financial Asset in a Market That Is Not Active*, which clarifies the application of SFAS 157 when the market for a financial asset is inactive. Specifically, SFAS No. 157-3 clarifies how (1) management's internal assumptions should be considered in measuring fair value when observable data are not present, (2) observable market information from an inactive market should be taken into account, and (3) the use of broker quotes or pricing services should be considered in assessing the relevance of observable and unobservable data to measure fair value. The guidance in SFAS No. 157-3 is effective immediately but does not have any impact on the Partnership's consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161: *Disclosures about Derivative Instruments and Hedging Activities, an amendment of Statement of Financial Accounting Standards No. 133* (or SFAS 161). The statement requires qualitative disclosures about an entity's objectives and strategies for using derivatives and quantitative disclosures about how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows. SFAS 161 is effective for fiscal years, and interim periods within those fiscal years, beginning after November 15, 2008, with early application allowed. SFAS 161 allows but does not require, comparative disclosures for earlier periods at initial adoption.

In December 2007, the FASB issued SFAS No. 141(R): *Business Combinations* (or SFAS 141(R)), which replaces SFAS No. 141, *Business Combinations*. This statement establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired. SFAS 141(R) also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS 141(R) is effective for fiscal years beginning after December 15, 2008. The Partnership is currently evaluating the potential impact, if any, of the adoption of SFAS 141(R) on its consolidated results of operations and financial condition.

TEEKAY OFFSHORE PARTNERS L.P. AND SUBSIDIARIES
(Successor to Teekay Offshore Partners Predecessor)
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS- (Cont'd)
(all tabular amounts stated in thousands of U.S. dollars, except unit and per unit data or unless otherwise indicated)

In December 2007, the FASB issued SFAS No. 160: *Noncontrolling Interests in Consolidated Financial Statements, an Amendment of Accounting Research Bulletin No. 51 (or SFAS 160)*. This statement establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent's ownership interest, and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. SFAS 160 also establishes disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS 160 is effective for fiscal years beginning after December 15, 2008. The Partnership is currently evaluating the potential impact, if any, of the adoption of SFAS 160 on its consolidated results of operations and financial condition.

2. Public Offerings

On December 19, 2006, the Partnership completed its initial public offering (or the *Offering*) of 8.05 million common units at a price of \$21.00 per unit. This included 1.05 million common units sold to the underwriters in connection with the exercise of their over-allotment option. The proceeds received by the Partnership from the Offering and the use of those proceeds are summarized as follows:

Proceeds received:

Sale of 8,050,000 common units at \$21.00 per unit	\$169,050
--	-----------

Use of proceeds from sale of common units:

Underwriting and structuring fees	\$11,088
Professional fees and other offering expenses to third parties	2,793
Repayment of promissory notes and redemption of 1.05 million common units from Teekay Corporation	155,169
	\$169,050

On June 18, 2008, the Partnership completed a follow-on public offering (or the *Follow-on Offering*) of 7.0 million common units at a price of \$20.00 per unit, for gross proceeds of \$140.0 million. Concurrently with the public offering, Teekay Corporation, which controls the Partnership, acquired 3.25 million common units of the Partnership in a private placement at the same public offering price for a total cost of \$65.0 million. On July 16, 2008, the underwriters for the public offering partially exercised their over-allotment option and purchased an additional 375,000 common units for an additional \$7.5 million in gross proceeds to the Partnership.

As a result of these equity transactions, the Partnership raised gross proceeds of \$216.8 million (including the General Partner's proportionate 2% capital contribution), and Teekay Corporation's ownership of the Partnership was reduced from 59.8% to 50.0% (including its indirect 2% general partner interest). The Partnership used the net proceeds from the equity offerings of approximately \$210.7 million to fund the acquisition of an additional 25% interest in Teekay Offshore Operating L.P. (or *OPCO*) from Teekay Corporation and to repay a portion of advances to the Partnership from *OPCO*.

3. Segment Reporting

The Partnership is engaged in the international marine transportation of crude oil through the operation of its oil tankers and FSO units. The Partnership's revenues are earned in international markets.

The Partnership has three reportable segments: its shuttle tanker segment; its conventional tanker segment; and its FSO segment. The Partnership's shuttle tanker segment consists of shuttle tankers operating primarily on fixed-rate contracts of affreightment, time-charter contracts or bareboat charter contracts. The Partnership's conventional tanker segment consists of conventional tankers operating on fixed-rate, time-charter contracts or bareboat charter contracts. The Partnership's FSO segment consists of its FSO units subject to fixed-rate, time-charter contracts or bareboat charter contracts. Segment results are evaluated based on income from vessel operations. The accounting policies applied to the reportable segments is the same as those used in the preparation of the Partnership's consolidated financial statements.

The following table presents voyage revenues and percentage of consolidated voyage revenues from continuing operations for customers that accounted for more than 10.0% of the Partnership's consolidated voyage revenues from continuing operations during the periods presented.

(U.S. dollars in millions)	Year Ended December 31, 2006			
	Year Ended December 31, 2008	Year Ended December 31, 2007	January 1 to December 18, 2006	December 19 to December 31, 2006
StatoilHydro ASA ⁽¹⁾⁽²⁾	\$320.7 or 37%	\$309.6 or 39%	\$187.6 or 30%	\$6.9 or 28%
Teekay Corporation ⁽³⁾	\$181.9 or 21%	\$154.6 or 20%	\$68.9 or 11%	\$5.3 or 22%
Petrobras Transporte S.A. ⁽¹⁾⁽²⁾	\$115.7 or 13%	\$100.8 or 13%	-	-

(1) Shuttle tanker segment.

(2) Statoil ASA and Petrobras Transporte S.A. are international oil companies.

(3) Shuttle tanker, conventional tanker and FSO segments.

TEEKAY OFFSHORE PARTNERS L.P. AND SUBSIDIARIES
(Successor to Teekay Offshore Partners Predecessor)
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS- (Cont'd)
(all tabular amounts stated in thousands of U.S. dollars, except unit and per unit data or unless otherwise indicated)

The following tables include results for these segments from continuing operations for the periods presented in these consolidated financial statements.

	Year Ended December 31, 2008				Year Ended December 31, 2007			
	Shuttle Tanker Segment	Conventional Tanker Segment	FSO Segment	Total	Shuttle Tanker Segment	Conventional Tanker Segment	FSO Segment	Total
	\$	\$	\$	\$	\$	\$	\$	\$
Voyage revenues	650,896	153,200	68,396	872,492	590,611	135,922	58,670	785,203
Voyage expenses	169,578	53,722	1,729	225,029	114,157	36,594	886	151,637
Vessel operating expenses	132,415	25,156	26,845	184,416	103,809	24,175	21,676	149,660
Time-charter hire expense	132,234	-	-	132,234	150,463	-	-	150,463
Depreciation and amortization	91,846	22,901	23,690	138,437	86,502	21,324	16,544	124,370
General and administrative ⁽¹⁾	51,996	8,674	3,560	64,230	50,776	7,828	3,800	62,404
Income from vessel operations	72,827	42,747	12,572	128,146	84,904	46,001	15,764	146,669
Expenditures for vessels and equipment ⁽²⁾	53,231	3,648	979	57,858	18,189	1,998	11,041	31,228

	Year Ended December 31, 2006							
	January 1 to December 18, 2006				December 19 to December 31, 2006			
	Shuttle Tanker Segment	Conventional Tanker Segment	FSO Segment	Total	Shuttle Tanker Segment	Conventional Tanker Segment	FSO Segment	Total
	\$	\$	\$	\$	\$	\$	\$	\$
Voyage revenues	516,187	66,673	34,654	617,514	19,785	3,383	1,229	24,397
Voyage expenses	85,451	4,841	1,029	91,321	2,995	51	56	3,102
Vessel operating expenses	77,085	18,754	12,152	107,991	3,222	624	451	4,297
Time charter hire expense	159,973	-	-	159,973	5,641	-	-	5,641
Depreciation and amortization	68,784	20,507	11,532	100,823	2,583	705	438	3,726
General and administrative ⁽¹⁾	48,490	11,571	2,953	63,014	1,863	218	96	2,177
Gain on sale of vessels and equipment - net of writedowns	(4,778)	-	-	(4,778)	-	-	-	-
Restructuring charge	-	832	-	832	-	-	-	-
Income from vessel operations	81,182	10,168	6,988	98,338	3,481	1,785	188	5,454
Equity income from joint ventures	6,321	-	-	6,321	-	-	-	-
Expenditures for vessels and equipment ⁽²⁾	25,055	6,024	-	31,079	-	-	-	-

(1) Includes direct general and administrative expenses and indirect general and administrative expenses (allocated to each segment based on estimated use of corporate resources).

(2) Excludes non-cash investing activities (see Note 14).

A reconciliation of total segment assets to total assets presented in the accompanying consolidated balance sheets is as follows:

	December 31, 2008 \$	December 31, 2007 \$
Shuttle tanker segment	1,517,961	1,559,261
Conventional tanker segment	332,795	255,460
FSO segment	108,304	131,080
Unallocated		
Cash and cash equivalents	131,488	121,224
Accounts receivable and other assets	89,544	116,880
Consolidated total assets	2,180,092	2,183,905

TEEKAY OFFSHORE PARTNERS L.P. AND SUBSIDIARIES
(Successor to Teekay Offshore Partners Predecessor)
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS- (Cont'd)
(all tabular amounts stated in thousands of U.S. dollars, except unit and per unit data or unless otherwise indicated)

4. Intangible Assets

As at December 31, 2008 and 2007, intangible assets consisted of:

	Weighted-Average Amortization Period (years)	December 31, 2008			December 31, 2007		
		Gross Carrying Amount \$	Accumulated Amortization \$	Net Carrying Amount \$	Gross Carrying Amount \$	Accumulated Amortization \$	Net Carrying Amount \$
Contracts of affreightment	10.2	124,250	(78,960)	45,290	124,250	(68,895)	55,355

Aggregate amortization expense of intangible assets for year ended December 31, 2008 was \$10.1 million (\$11.1 million – 2007, \$12.1 million - 2006). Amortization of intangible assets for the five years subsequent to December 31, 2008 is expected to be \$9.1 million (2009), \$8.1 million (2010), \$7.0 million (2011), \$6.0 million (2012) and \$5.0 million (2013).

5. Accrued Liabilities

	December 31, 2008 \$	December 31, 2007 \$
Voyage and vessel	31,162	26,015
Interest	11,994	10,932
Payroll and benefits	1,311	1,517
	<u>44,467</u>	<u>38,464</u>

6. Long-Term Debt

	December 31, 2008 \$	December 31, 2007 \$
U.S. Dollar-denominated Revolving Credit Facilities due through 2018	1,314,264	1,205,808
U.S. Dollar-denominated Term Loans due through 2017	252,172	311,659
	<u>1,566,436</u>	<u>1,517,467</u>
Less current portion	125,503	64,060
Total	<u>1,440,933</u>	<u>1,453,407</u>

As at December 31, 2008, the Partnership had seven long-term revolving credit facilities (collectively, the *Revolvers*), which, as at such date, provided for borrowings of up to \$1.46 billion, of which \$142.7 million was undrawn. The total amount available under the revolving credit facilities reduces by \$126.1 million (2009), \$132.8 million (2010), \$140.0 million (2011), \$147.6 million (2012), \$169.6 million (2013) and \$740.9 million (thereafter). Five of the revolving credit facilities are guaranteed by certain subsidiaries of the Partnership for all outstanding amounts and contain covenants that require OPCO to maintain the greater of a minimum liquidity (cash, cash equivalents and undrawn committed revolving credit lines with at least six months to maturity) of at least \$75.0 million and 5.0% of OPCO's total consolidated debt. The remaining revolving credit facilities are guaranteed by Teekay Corporation and contain covenants that require Teekay Corporation to maintain the greater of a minimum liquidity of at least \$50.0 million and 5.0% of Teekay Corporation's total consolidated debt which has recourse to Teekay Corporation. The revolving credit facilities are collateralized by first-priority mortgages granted on 33 of the Partnership's vessels, together with other related security.

As at December 31, 2008, five of the Partnership's six 50% owned subsidiaries had an outstanding term loan, which in the aggregate totaled \$252.2 million. The term loans have varying maturities through 2017 and semi-annual payments that reduce over time. All term loans are collateralized by first-priority mortgages on the vessels to which the loans relate, together with other related security. As at December 31, 2008, the Partnership had guaranteed \$76.0 million of these term loans, which represents its 50% share of the outstanding vessel mortgage debt of five of these 50% owned subsidiaries. The other owner and Teekay Corporation have guaranteed the remaining \$176.2 million.

Interest payments on the revolving credit facilities and the term loans are based on LIBOR plus a margin. At December 31, 2008, the margins ranged between 0.45% and 0.95%. At December 31, 2007 the margins ranged between 0.45% and 0.80%. The weighted-average effective interest rate on the Partnership's long-term debt as at December 31, 2008 was 3.4% (December 31, 2007 – 5.7%). This rate does not reflect the effect of our interest rate swaps (Note 11).

The aggregate annual long-term debt principal repayments required to be made subsequent to December 31, 2008 are \$125.5 million (2009), \$134.7 million (2010), \$169.3 million (2011), \$147.1 million (2012), \$155.4 million (2013), and \$834.4 million (thereafter).

TEEKAY OFFSHORE PARTNERS L.P. AND SUBSIDIARIES
(Successor to Teekay Offshore Partners Predecessor)
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS- (Cont'd)
(all tabular amounts stated in thousands of U.S. dollars, except unit and per unit data or unless otherwise indicated)

7. Leases

Charters-out and Direct Financing Lease

Time charters and bareboat charters of the Partnership's vessels to customers are accounted for as operating leases. The carrying amount of the vessels employed on operating leases at December 31, 2008 was \$1.3 billion (2007 - \$1.3 billion). Leasing of the VOC equipment is accounted for as direct financing leases. As at December 31, 2008, the minimum lease payments receivable under the direct financing leases approximated \$94.5 million, including unearned income of \$15.9 million.

As at December 31, 2008, minimum scheduled future revenues under time charters and bareboat charters and future scheduled payments under the direct financing leases, to be received by the Partnership, then in place were approximately \$1.60 billion, comprised of \$376.4 million (2009), \$268.1 million (2010), \$194.4 million (2011), \$158.3 million (2012), \$133.5 million (2013) and \$468.4 million (thereafter).

The minimum scheduled future revenues should not be construed to reflect total charter hire revenues for any of the years. In addition, minimum scheduled future revenues have been reduced by estimated off-hire time for period maintenance.

Charters-in

As at December 31, 2008, minimum commitments owing by the Partnership under vessel operating leases by which the Partnership charters-in vessels were approximately \$393.9 million, comprised of \$109.8 million (2009), \$88.6 million (2010), \$62.9 million (2011), \$56.8 million (2012), \$46.8 million (2013) and \$29.0 million (thereafter). The Partnership recognizes the expense from these charters, which is included in time-charter hire expense, on a straight-line basis over the firm period of the charters.

8. Fair Value of Measurements

Effective January 1, 2008, the Partnership adopted SFAS No. 157, *Fair Value Measurements*. In accordance with Financial Accounting Standards Board Staff Position No. FAS 157-2, *Effective Date of FASB Statement No. 157*, the Partnership deferred the adoption of SFAS No. 157 for its nonfinancial assets and nonfinancial liabilities, except those items recognized or disclosed at fair value on an annual or more frequently recurring basis, until January 1, 2009. The adoption of SFAS No. 157 did not have a material impact on the Partnership's fair value measurements.

SFAS No. 157 clarifies the definition of fair value, prescribes methods for measuring fair value, establishes a fair value hierarchy based on the inputs used to measure fair value and expands disclosure about the use of fair value measurements. The fair value hierarchy has three levels based on the reliability of the inputs used to determine fair value as follows:

- Level 1. Observable inputs such as quoted prices in active markets;
- Level 2. Inputs, other than the quoted prices in active markets, that are observable either directly or indirectly; and
- Level 3. Unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

The following methods and assumptions were used to estimate the fair value of each class of financial instrument:

Cash and cash equivalents - The fair value of the Partnership's cash and cash equivalents approximate their carrying amounts reported in the accompanying consolidated balance sheets.

Due to / from affiliates - The fair value of the amounts due to and from affiliates approximate their carrying amounts reported in the accompanying consolidated balance sheets.

Long-term debt - The fair values of the Partnership's fixed-rate and variable-rate long-term debt are either based on quoted market prices or estimated using discounted cash flow analyses, based on rates currently available for debt with similar terms and remaining maturities and the current credit worthiness of the Partnership.

Due to joint venture partners - The fair value of the Partnership's loans from joint venture partners approximate their carrying amounts reported in the accompanying consolidated balance sheets.

Derivative instruments - The fair value of the Partnership's derivative instruments is the estimated amount that the Partnership would receive or pay to terminate the agreements at the reporting date, taking into account current interest rates, foreign exchange rates and the current credit worthiness of both the Partnership and the derivative counterparties. The estimated amount is the present value of future cash flows. Given the current volatility in the credit markets, it is reasonably possible that the amount recorded as a derivative liability could vary by a material amount in the near term.

TEEKAY OFFSHORE PARTNERS L.P. AND SUBSIDIARIES
(Successor to Teekay Offshore Partners Predecessor)
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS- (Cont'd)
(all tabular amounts stated in thousands of U.S. dollars, except unit and per unit data or unless otherwise indicated)

The estimated fair value of the Partnership's financial instruments is as follows:

	Fair Value Hierarchy Level	December 31, 2008		December 31, 2007	
		Carrying Amount \$	Fair Value \$	Carrying Amount \$	Fair Value \$
Cash and cash equivalents	-	131,488	131,488	121,224	121,224
Due from affiliate (note 10y)	-	10,110	10,110	18,350	18,350
Due to affiliate (note 10y)	-	(8,715)	(8,715)	(17,554)	(17,554)
Long-term debt	Level 2	(1,566,436)	(1,476,608)	(1,517,467)	(1,517,467)
Due to joint venture partners	-	(21,019)	(21,019)	(3,534)	(3,534)
Derivative instruments ⁽¹⁾ (note 11)					
Interest rate swap agreements ⁽²⁾	Level 2	(159,169)	(159,169)	(21,050)	(21,050)
Foreign currency forward contracts	Level 2	(37,554)	(37,554)	1,122	1,122

(1) The Partnership transacts all of its derivative instruments through investment-grade rated financial institutions at the time of the transaction and requires no collateral from these institutions.

(2) The fair value of the Partnership's interest rate swap agreements includes \$3.4 million of accrued interest which is recorded in accrued liabilities on the balance sheet.

9. Restructuring Charge and Other Income – Net

During the year ended December 31, 2006, the Predecessor relocated certain operational functions to Singapore. As a result, the Predecessor incurred \$0.8 million of restructuring costs during 2006.

	Year Ended December 31, 2008 \$	Year Ended December 31, 2007 \$	Year Ended December 31, 2006	
			January 1 to December 18, 2006 \$	December 19 to December 31, 2006 \$
Volatile organic compound emissions plant lease income	9,727	10,960	11,037	408
Miscellaneous	2,209	(557)	(2,670)	(99)
Other income – net	11,936	10,403	8,367	309

10. Related Party Transactions and Balances

a. On July 1, 2006, the Predecessor sold Navion Shipping Ltd. to a subsidiary of Teekay Corporation for \$53.7 million. The resulting gain on sale of \$18.5 million was accounted for as an equity contribution by Teekay Corporation. Please read Note 18.

During the first half of 2006, three of the Predecessor's conventional tankers were employed on time-charters with a subsidiary of Teekay Corporation. Pursuant to these charter contracts, OPCO earned voyage revenues of \$5.3 million during the first half of 2006.

During the first half of 2006, the Predecessor earned \$5.1 million of management fees from ship management services provided to a subsidiary of Teekay Corporation, relating to the vessels chartered from Navion Shipping Ltd during that period.

b. During 2006, the Predecessor paid \$11.9 million to Teekay Corporation for it to assume the time-charter contract for one of the Predecessor's in-chartered shuttle tankers, the Borga. The resulting \$11.9 million loss on sale was accounted for as an equity distribution to Teekay Corporation.

c. In 2006, prior to the Offering, the Predecessor sold to Teekay Corporation certain subsidiaries and fixed assets for \$64.7 million. The resulting \$23.3 million gain on sale was accounted for as an equity contribution by Teekay Corporation.

d. Prior to the Offering, the Predecessor settled its Norwegian Kroner-denominated demand promissory note of 1.1 billion Norwegian Kroner (\$166.3 million) and its Australian Dollar-denominated demand promissory note of 25.5 million Australian Dollars (\$19.2 million) owing to Teekay Corporation. Interest expense incurred on these demand promissory notes for the period prior to the Offering (January 1 to December 18, 2006) was \$12.9 million.

e. In October 2006, Teekay Corporation loaned 5.6 billion Norwegian Kroner (\$863.0 million) to a subsidiary of OPCO primarily for the purchase of eight Aframax conventional crude oil tankers from Teekay Corporation. Immediately preceding the Offering, this interest-bearing loan was sold to OPCO. The interest expense incurred on this loan prior to its sale to OPCO was \$14.2 million.

TEEKAY OFFSHORE PARTNERS L.P. AND SUBSIDIARIES
(Successor to Teekay Offshore Partners Predecessor)
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS- (Cont'd)
(all tabular amounts stated in thousands of U.S. dollars, except unit and per unit data or unless otherwise indicated)

- f. Nine of OPCO's conventional tankers are employed on long-term time-charter contracts with a subsidiary of Teekay Corporation. Under the terms of eight of these nine time-charter contracts, OPCO is responsible for the bunker fuel expenses; however, OPCO adds the approximate amounts of these expenses to the daily hire rate plus a 4.5% margin. Pursuant to these time-charter contracts, OPCO earned voyage revenues of \$144.5 million, \$128.4 million and \$22.3 million for the year ended December 31, 2008 and 2007 and for the three months ended December 31, 2006, respectively.
- During the first nine months of 2006, seven of these nine tankers were employed on time-charter contracts with a subsidiary of Teekay Corporation. The rates earned by each vessel, which were generally lower than market rates, depended upon the cash flow requirements of each vessel, which included operating expenses, loan principal and interest payments and drydock expenditures. Pursuant to these time-charter contracts, the Predecessor earned voyage revenues of \$24.6 million during the first nine months of 2006.
- g. One of OPCO's FSO units and one of OPCO's conventional tankers were employed on short-term bareboat charters with a subsidiary of Teekay Corporation during the last half of 2006. Pursuant to these charter contracts, OPCO earned voyage revenues of \$3.4 million revenues during the last half of 2006.
- h. Two of OPCO's shuttle tankers are employed on long-term bareboat charters with a subsidiary of Teekay Corporation. Pursuant to these charter contracts, OPCO earned voyage revenues of \$14.8 million, \$14.2 million and \$3.6 million during the year ended December 31, 2008 and 2007, and the three months ended December 31, 2006, respectively.
- i. Two of OPCO's FSO units are employed on long-term bareboat charters with a subsidiary of Teekay Corporation. Pursuant to these charter contracts, OPCO earned voyage revenues of \$11.2 million, \$12.0 million and \$10.2 million during the years ended December 31, 2008, 2007 and 2006, respectively.
- j. A subsidiary of Teekay Corporation has entered into a services agreement with a subsidiary of OPCO, pursuant to which the subsidiary of OPCO provides the Teekay Corporation subsidiary with ship management services. Pursuant to this agreement, during the year ended December 31, 2008 and 2007 and the three months ended December 31, 2006, OPCO earned management fees of \$3.3 million, \$3.3 million and \$0.5 million, respectively.
- k. Eight of OPCO'S Aframax conventional oil tankers and three FSO units are managed by subsidiaries of Teekay Corporation. Pursuant to the associated management services agreements, the Partnership incurred general and administrative expenses of \$3.7 million, \$4.5 million and \$6.1 million during the years ended December 31, 2008, 2007, and 2006, respectively. During the years ended December 31, 2007 and 2006, \$0.1 million, and \$0.8 million, respectively, of general and administrative expenses attributable to the operations of the *Dampier Spirit* were incurred by Teekay Corporation and have been allocated to the Partnership as part of the results of the Dropdown Predecessor.
- l. The Partnership, OPCO and certain of OPCO's operating subsidiaries have entered into services agreements with certain subsidiaries of Teekay Corporation in connection with the Offering, pursuant to which Teekay Corporation subsidiaries provide the Partnership, OPCO and its operating subsidiaries with administrative, advisory and technical services and ship management services. Pursuant to these service agreements, the Partnership incurred \$50.3 million and \$52.7 million, respectively, of these costs during the year ended December 31, 2008 and 2007. Prior to the Offering, the shore-based staff who provided these services to the Predecessor were transferred to a subsidiary of Teekay Corporation. During the year ended December 31, 2006, \$21.6 million of general and administrative expenses attributable to the operations of the Predecessor prior to the Offering were incurred by Teekay Corporation and have been allocated to the Predecessor.
- m. Pursuant to the Partnership's partnership agreement, the Partnership reimburses the General Partner for all expenses incurred by the Partnership that are necessary or appropriate for the conduct of the Partnership's business. During the years ended December 31, 2008 and 2007, the Partnership incurred \$ 0.6 million and \$0.8 million of these costs, respectively.
- n. The Partnership has entered into an omnibus agreement with Teekay Corporation, Teekay LNG Partners L.P., the General Partner and others governing, among other things, when the Partnership, Teekay Corporation and Teekay LNG Partners L.P. may compete with each other and certain rights of first offering on liquefied natural gas carriers, oil tankers, shuttle tankers, FSO units and floating production, storage and offloading units.
- o. In July 2007, the Partnership acquired interests in two double-hull shuttle tankers from Teekay Corporation for a total cost of \$159.1 million, including assumption of debt of \$93.7 million and the related interest rate swap agreement. The Partnership acquired Teekay Corporation's 100% interest in the 2000-built *Navion Bergen* and its 50% interest in the 2006-built *Navion Gothenburg*, together with their respective 13-year, fixed-rate bareboat charters to Petroleo Brasileiro S.A. The purchases were financed with one of the Partnership's existing Revolvers and the assumption of debt. The excess of the proceeds paid by the Partnership over Teekay Corporation's depreciated historical cost was accounted for as an equity distribution to Teekay Corporation of \$25.4 million.
- p. In October 2007, the Partnership acquired from Teekay Corporation an FSO unit, the *Dampier Spirit*, along with its 7-year fixed-rate time-charter to Apache Corporation, for a total cost of \$30.3 million. The purchase was financed with one of the Partnership's existing Revolvers. The excess of the proceeds paid by the Partnership over Teekay Corporation's depreciated historical cost was accounted for as an equity distribution to Teekay Corporation of \$13.9 million.

TEEKAY OFFSHORE PARTNERS L.P. AND SUBSIDIARIES
(Successor to Teekay Offshore Partners Predecessor)
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS- (Cont'd)
(all tabular amounts stated in thousands of U.S. dollars, except unit and per unit data or unless otherwise indicated)

- q. In December 2007, Teekay Corporation contributed a \$65.6 million, nine-year, 4.98% interest rate swap agreement (used to hedge the debt assumed in the purchase of the *Navion Bergen*) having a fair value liability of \$2.6 million (Note 11), to the Partnership for no consideration and was accounted for as an equity distribution to Teekay Corporation.
- r. In December 2007, Teekay Corporation agreed to reimburse OPCO for certain costs relating to events which occurred prior to the Offering, totalling \$4.8 million, including the settlement of a customer dispute in respect of vessels delivered prior to the Offering and other costs.
- s. In January 2007, Teekay Corporation contributed foreign exchange contracts for the forward purchase of a total of Australian Dollars 4.5 million having a fair value asset of \$0.1 million, net of non-controlling interest, to OPCO for no consideration and was accounted for as an equity contribution from Teekay Corporation. The foreign currency forward contracts matured by December 2007.
- t. In March 2008, Teekay Corporation agreed to reimburse the Partnership for repair costs relating to one of the Partnership's shuttle tankers. The vessel was purchased from Teekay Corporation in July 2007 and had, as of the date of acquisition, an inherent minor defect that required repairs. Pursuant to this agreement, Teekay Corporation reimbursed \$0.7 million of these costs during the year ended December 31, 2008.
- u. In March 2008, a subsidiary of OPCO sold certain vessel equipment to a subsidiary of Teekay Corporation for proceeds equal to its net book value of \$1.4 million.
- v. Concurrently with the closing of the Partnership's Follow-on Offering, the Partnership acquired from Teekay Corporation an additional 25% interest in OPCO for \$205.5 million, thereby increasing the Partnership's ownership interest in OPCO to 51%. The Partnership financed the acquisition with the net proceeds from the Follow-on Offering and a concurrent private placement of common units to Teekay Corporation. See Note 2. In connection with the valuation of the purchase of the additional 25% interest in OPCO, the Partnership incurred a fairness opinion fee of \$1.1 million. The excess of the proceeds paid by the Partnership over Teekay Corporation's historical book value for the 25% interest in OPCO was accounted for as an equity distribution to Teekay Corporation of \$91.6 million.
- w. On June 18, 2008, OPCO acquired from Teekay Corporation two ship owning subsidiaries (SPT Explorer L.L.C. and the SPT Navigator L.L.C.) for a total cost of approximately \$106.0 million, including the assumption of third-party debt of approximately \$89.3 million and the non-cash settlement of related party working capital of \$1.2 million. The acquired subsidiaries own two 2008-built Aframax lightering tankers (the *SPT Explorer* and the *SPT Navigator*) and their related 10-year, fixed-rate bareboat charters (with options exercisable by the charterer to extend up to an additional five years) entered into with Skaugen PetroTrans, a joint venture in which Teekay Corporation owns a 50% interest. These two lightering tankers are specially designed to be used in ship-to-ship oil transfer operations. This purchase was financed with the assumption of debt, together with cash balances. The excess of the proceeds paid by the Partnership over Teekay Corporation's historical book value was accounted for as an equity distribution to Teekay Corporation of \$16.2 million. Pursuant to the bareboat charters for the vessels, OPCO earned voyage revenues of \$8.7 million for the year ended December 31, 2008 (including voyage revenues earned as part of the Dropdown Predecessor prior to OPCO's acquisition of the vessels – see Note 1).
- x. In June 2008, Teekay Corporation agreed to reimburse OPCO for certain costs relating to events which occurred prior to the Partnership's Offering in December 2006, totalling \$0.7 million, primarily relating to the settlement of repair costs not covered by insurance providers for work performed in early 2006 on two of OPCO's shuttle tankers.
- y. At December 31, 2008, due from affiliates totaled \$10.1 million (December 31, 2007 - \$18.4 million) and due to affiliates totaled \$8.7 million (December 31, 2007 - \$17.6 million). Due to and from affiliate are non-interest bearing and unsecured.
- z. During the year ended December 31, 2007, \$1.2 million of interest expense attributable to the operations of the *Navion Bergen* was incurred by Teekay Corporation and has been allocated to the Partnership as part of the results of the Dropdown Predecessor.
- aa. During August 2008, two of OPCO's in-chartered shuttle tankers were employed on a single-voyage charter with a subsidiary of Teekay Corporation. Pursuant to this charter contract, OPCO earned voyage revenues of \$11.3 million for the year ended December 31, 2008.

11. Derivative Instruments and Hedging Activities

The Partnership uses derivatives in accordance with its overall risk management policies. The following summarizes the Partnership's risk strategies with respect to market risk from foreign currency fluctuations and changes in interest rates.

The Partnership hedges portions of its forecasted expenditures denominated in foreign currencies with foreign currency forward contracts. These foreign currency forward contracts are generally designated, for accounting purposes, as cash flow hedges of forecasted foreign currency expenditures. Where such instruments are designated and qualify as cash flow hedges, the effective portion of the changes in their fair value is recorded in accumulated other comprehensive income (loss), until the hedged item is recognized in earnings. At such time, the respective amount in accumulated other comprehensive income (loss) is released to earnings and is recorded within operating expenses, based on the nature of the expense. The ineffective portion of these foreign currency forward contracts has also been reported in operating expenses, based on the nature of the expense. During the years ended December 31, 2008 and 2007, the Partnership recognized the following unrealized gains (losses) in vessel operating expenses, general and administrative and foreign currency exchange gain (loss) relating to the ineffective portion of its foreign currency forward contracts:

TEEKAY OFFSHORE PARTNERS L.P. AND SUBSIDIARIES
(Successor to Teekay Offshore Partners Predecessor)
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS- (Cont'd)
(all tabular amounts stated in thousands of U.S. dollars, except unit and per unit data or unless otherwise indicated)

	Year Ended December 31, 2008 \$	Year Ended December 31, 2007 \$
Vessel operating expenses	4,942	-
General and administrative	1,422	(57)
Foreign currency exchange loss	(14)	-
Total	<u>6,350</u>	<u>(57)</u>

Changes in fair value of foreign currency forward contracts that are not designated, for accounting purposes, as cash flow hedges are recognized in earnings and are reported in operating expenses, based on the nature of the expense being hedged. During the years ended December 31, 2008 and 2007, the Partnership recognized the following unrealized gains (losses) in vessel operating expenses, general and administrative and foreign currency exchange gain (loss) relating to foreign currency forward contracts that are not designated as cash flow hedges:

	Year Ended December 31, 2008 \$	Year Ended December 31, 2007 \$
Vessel operating expenses	(2,020)	(429)
General and administrative	(4,159)	-
Foreign currency exchange gain	22	59
Total	<u>(6,157)</u>	<u>(370)</u>

During the year ended December 31, 2008, the Partnership reclassified \$0.3 million from accumulated other comprehensive income to general and administrative expenses, on the discontinuation of hedge accounting for certain foreign currency forward contracts, where the forecasted transactions were no longer deemed to be probable of occurring.

As at December 31, 2008, the Partnership was committed to the following foreign currency forward contracts:

	Contract Amount in Foreign Currency (thousands)	Fair Value / Carrying Amount of Liability (thousands of U.S. Dollars)	Average Forward Rate ⁽¹⁾	Expected Maturity 2009 (in thousands of U.S. Dollars)	2010 (in thousands of U.S. Dollars)
Norwegian Kroner	1,228,764	\$35,157	5.83	\$114,718	\$96,068
Australian Dollar	3,300	646	1.12	2,952	-
British Pound	443	199	0.52	750	100
Euro	24,725	1,552	0.69	23,702	12,254
		<u>\$37,554</u>		<u>\$142,122</u>	<u>\$108,422</u>

(1) Average forward rate represents the contracted amount of foreign currency one U.S. Dollar will buy.

As at December 31, 2008, the Partnership's accumulated other comprehensive loss included \$17.0 million of unrealized losses on foreign currency forward contracts designated as cash flow hedges. As at December 31, 2008, the Partnership estimated, based on then current foreign exchange rates, that it would reclassify approximately \$11.6 million of net losses on foreign currency forward contracts from accumulated other comprehensive loss to earnings during the next 12 months.

The Partnership enters into interest rate swaps, which exchange a receipt of floating interest for a payment of fixed interest to reduce the Partnership's exposure to interest rate variability on its outstanding floating-rate debt. The Partnership has not designated, for accounting purposes, its interest rate swaps as cash flow hedges of its USD LIBOR denominated borrowings. Unrealized gains or losses relating to the change in fair value of the Partnership's interest rate swaps have been reported in interest expense in the consolidated statements of income (loss). During the year ended December 31, 2008, the Partnership recognized unrealized losses of \$132.6 million (December 31, 2007 - \$45.5 million), relating to the changes in fair value of its interest rate swaps.

As at December 31, 2008, the Partnership was committed to the following interest rate swap agreements:

	Interest Rate Index	Principal Amount \$	Fair Value / Carrying Amount of Liability \$	Weighted- Average Remaining Term (Years)	Fixed Interest Rate (%) ⁽¹⁾
U.S. Dollar-denominated interest rate swaps	LIBOR	935,000	88,580	5.5	4.7
U.S. Dollar-denominated interest rate swaps ⁽²⁾	LIBOR	397,279	70,589	12.4	5.0
		<u>1,332,279</u>	<u>159,169</u>		

TEEKAY OFFSHORE PARTNERS L.P. AND SUBSIDIARIES
(Successor to Teekay Offshore Partners Predecessor)
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS- (Cont'd)
(all tabular amounts stated in thousands of U.S. dollars, except unit and per unit data or unless otherwise indicated)

- (1) Excludes the margin the Partnership pays on its variable-rate debt, which as at December 31, 2008, ranged from 0.45% and 0.95%.
(2) Principal amount reduces quarterly or semi-annually.
(3) The fair value of the Partnership's interest rate swap agreements includes \$3.4 million of accrued interest which is recorded in accrued liabilities on the balance sheet.

The Partnership is exposed to credit loss in the event of non-performance by the counter-parties to the foreign currency forward contracts and the interest rate swap agreements. In order to minimize counterparty risk, the Partnership only enters into derivative transactions with counterparties that are rated A or better by Standard & Poor's or Aa3 or better by Moody's at the time of the transactions. In addition, to the extent possible and practical, interest rate swaps are entered into with different counterparties to reduce concentration risk.

12. Income Taxes

The significant components of the Partnership's deferred tax liabilities and assets are as follows:

	December 31, 2008 \$	December 31, 2007 \$
Deferred tax liabilities:		
Vessels and equipment	50,231	84,077
Goodwill and intangible assets	-	266
Long-term debt	11,505	94,071
Total deferred tax liabilities	61,736	178,414
Deferred tax assets:		
Other	1,521	1,012
Tax losses carried forward ⁽¹⁾	47,567	100,096
Total deferred tax assets	49,088	101,108
Net deferred tax liabilities ⁽²⁾	12,648	77,306
Current portion	-	-
Long-term portion of net deferred tax liabilities	12,648	77,306

- (1) The net operating loss carryforwards of \$169.0 million are available to offset future taxable income in the applicable jurisdictions, and can be carried forward indefinitely.
(2) The change in the net deferred tax liabilities is related to the change in temporary differences and foreign exchange gains.

Substantially all of the Partnership's net income (loss) resulted from the operations of subsidiaries that were subject to income taxes in their countries of incorporation.

The components of the provision for income taxes are as follows:

	Year Ended December 31, 2008 \$	Year Ended December 31, 2007 \$	Year Ended December 31, 2006 \$
Current	(752)	-	(2,956)
Deferred	57,456	10,516	(425)
Income tax recovery (expense)	56,704	10,516	(3,381)

The Partnership operates in countries that have differing tax laws and rates. Consequently a consolidated weighted average tax rate will vary from year to year according to the source of earnings or losses by country and the change in applicable tax rates. Reconciliations of the tax charge related to the current year at the applicable statutory income tax rates and the actual tax charge related to the current year are as follows:

	Year Ended December 31, 2008 \$	Year Ended December 31, 2007 \$	Year Ended December 31, 2006 \$
Net loss before taxes	(74,338)	(6,558)	(25,449)
Net loss not subject to taxes	(314,613)	160,672	(5,413)
Net income subject to taxes	240,275	(167,230)	(20,036)
At applicable statutory tax rates	58,939	(54,303)	(8,095)
Permanent differences and adjustments related to currency differences	(115,643)	43,787	11,476
Tax (recovery) expense related to current year	(56,704)	(10,516)	3,381

TEEKAY OFFSHORE PARTNERS L.P. AND SUBSIDIARIES
(Successor to Teekay Offshore Partners Predecessor)
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS- (Cont'd)
(all tabular amounts stated in thousands of U.S. dollars, except unit and per unit data or unless otherwise indicated)

13. Commitments and Contingencies

The Partnership may, from time to time, be involved in legal proceedings and claims that arise in the ordinary course of business. The Partnership believes that any adverse outcome, individually or in the aggregate, of any existing claims would not have a material effect on its financial position, results of operations or cash flows, when taking into account its insurance coverage and indemnifications from charterers or Teekay Corporation.

14. Supplemental Cash Flow Information

- a) The changes in non-cash working capital items related to operating activities for the years ended December 31, 2008, 2007 and 2006 are as follows:

	Year Ended December 31, 2008 \$	Year Ended December 31, 2007 \$	Year Ended December 31, 2006 \$
Accounts receivable	2,745	(16,206)	3,452
Prepaid expenses and other assets	13,944	(1,957)	4,164
Accounts payable and accrued liabilities	4,306	(6,126)	4,643
Advances from (to) affiliate	1,948	(9,417)	38,780
	22,943	(33,706)	51,039

- b) Cash interest paid (including interest paid by the Dropdown Predecessor) during the years ended December 31, 2008, 2007, and 2006 totaled \$76.0 million, \$73.9 million, and \$44.0 million, respectively.
- c) Taxes paid (including taxes paid by the Dropdown Predecessor) during the years ended December 31, 2008, 2007 and 2006 totaled \$1.1 million, \$1.8 million, and \$0.2 million, respectively.
- d) The Partnership's consolidated statement of cash flows for the years ended December 31, 2008, 2007 and 2006 reflect the Dropdown Predecessor as if the Partnership had acquired the Dropdown Predecessor when each respective vessel began operations under the ownership of Teekay Corporation. If Teekay Corporation financed the construction or purchase of the vessel prior to the Dropdown Predecessor being included in the results of the Partnership, the expenditures for the vessel by Teekay Corporation have been treated as a non-cash transaction in the Partnership's consolidated statement of cash flows. The non-cash investing activities related to the Dropdown Predecessor were \$90.5 million and \$71.6 million for expenditures for vessels and equipment in the years ended December 31, 2008 and December 31, 2007, respectively.
- e) Net change in parent's equity in the Dropdown Predecessor includes the equity of the Dropdown Predecessor when initially pooled for accounting purposes and any subsequent non-cash equity transactions of the Dropdown Predecessor.

15. Vessel and Equipment Sales and Write-downs

a) Vessel Sales

During 2008, a subsidiary of OPCO sold certain vessel equipment to a subsidiary of Teekay Corporation for proceeds equal to its net book value of \$1.4 million.

During 2006, the Predecessor sold a 1981-built shuttle tanker. The Predecessor recorded a gain of \$6.4 million and a non-controlling interest expense of \$3.2 million relating to the sale.

b) Equipment Writedowns

During 2006, the Predecessor incurred a \$2.2 million write-down of certain offshore equipment. This writedown occurred due to a reassessment of the estimated net realizable value of this equipment and follows a \$12.2 million write-down in 2005 arising from the early termination of a contract for the equipment.

16. Partners' Capital and Net Income (Loss) Per Unit

At December 31, 2008, of our total common units outstanding, 50.01% were held by the public and the remaining units were held by a subsidiary of Teekay Corporation.

Limited Partners' Rights

Significant rights of the limited partners include the following:

- Right to receive distribution of available cash within approximately 45 days after the end of each quarter.

TEEKAY OFFSHORE PARTNERS L.P. AND SUBSIDIARIES
(Successor to Teekay Offshore Partners Predecessor)
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS- (Cont'd)
(all tabular amounts stated in thousands of U.S. dollars, except unit and per unit data or unless otherwise indicated)

- No limited partner shall have any management power over the Partnership's business and affairs; the general partner shall conduct, direct and manage our activities.
- The General Partner may be removed if such removal is approved by unitholders holding at least 66 2/3% of the outstanding units voting as a single class, including units held by the General Partner and its affiliates.

Subordinated Units

All of the Partnership's subordinated units are held by a subsidiary of Teekay Corporation. Under the partnership agreement, during the subordination period applicable to the Partnership's subordinated units, the common units will have the right to receive distributions of available cash from operating surplus in an amount equal to the minimum quarterly distribution of \$0.35 per quarter, plus any arrearages in the payment of the minimum quarterly distribution on the common units from prior quarters, before any distributions of available cash from operating surplus may be made on the subordinated units. Distribution arrearages do not accrue on the subordinated units. The purpose of the subordinated units is to increase the likelihood that during the subordination period there will be available cash to be distributed on the common units.

The subordination period will extend until the first day of any quarter beginning after December 31, 2009. Thereafter the subordination period will terminate automatically and the subordinated units will convert into common units on a one-for-one basis if certain tests are met.

For the purpose of the net income (loss) per unit calculation (as defined below), during the first and fourth quarters of 2008, the Partnership incurred a net loss and, consequently, the assumed distributions of net loss resulted in an equal distribution of net loss between the subordinated unit holders and common unit holders. During the second and third quarters of 2008, net income exceeded the minimum quarterly distribution of \$0.35 per unit and, consequently, the assumed distribution of net income resulted in an equal distribution of net income between the subordinated unit holders and common unit holders.

Incentive Distribution Rights

The General Partner is entitled to incentive distributions if the amount the Partnership distributes to unitholders with respect to any quarter exceeds specified target levels shown below:

<u>Quarterly Distribution Target Amount (per unit)</u>	<u>Unitholders</u>	<u>General Partner</u>
Minimum quarterly distribution of \$0.35	98%	2%
Up to \$0.4025	98%	2%
Above \$0.4025 up to \$0.4375	85%	15%
Above \$0.4375 up to \$0.525	75%	25%
Above \$0.525	50%	50%

For the purpose of the net income (loss) per unit calculation, of the four quarters that comprise the year ended December 31, 2008, the Partnership incurred a net loss in the first and fourth quarter and, consequently the assumed distributions of net losses did not result in the use of the increasing percentages to calculate the General Partner's interest in net losses. During the second and third quarter of 2008, net income exceeded \$0.4025 per unit and, consequently, the assumed distribution of net income resulted in the use of the increasing percentages to calculate the General Partner's interest in net income.

In the event of a liquidation, all property and cash in excess of that required to discharge all liabilities will be distributed to the unitholders and our general partner in proportion to their capital account balances, as adjusted to reflect any gain or loss upon the sale or other disposition of the Partnership's assets in liquidation in accordance with the partnership agreement.

Net Income (Loss) Per Unit

Net income (loss) per unit is determined by dividing net income, after deducting the amount of net income attributable to the Dropdown Predecessor and the amount of net income (loss) allocated to the General Partner's interest from the issuance date of the common units of December 19, 2006, by the weighted-average number of units outstanding during the applicable period. For periods prior to December 19, 2006, such units are deemed equal to the common and subordinated units received by Teekay Corporation in exchange for net assets contributed to the Partnership in connection with its initial public offering, or 12,600,000 units.

As required by Emerging Issues Task Force Issue No. 03-6, *Participating Securities and Two-Class Method under FASB Statement No. 128, Earnings Per Share*, the interests of the General Partner, common unit holders and subordinated unitholders in net income are calculated as if all net income for periods subsequent to December 19, 2006 was distributed according to the terms of the Partnership's partnership agreement, regardless of whether those earnings would or could be distributed. The partnership agreement does not provide for the distribution of net income; rather, it provides for the distribution of available cash, which is a contractually defined term that generally means all cash on hand at the end of each quarter after establishment of cash reserves. Unlike available cash, net income is affected by non-cash items such as depreciation and amortization, unrealized gains and losses on derivative instruments and foreign currency translation gains (losses).

Pursuant to the partnership agreement, income allocations are made on a quarterly basis; therefore earnings per limited partner unit for each year is calculated as the sum of the quarterly earnings per limited partner unit for each of the four quarters in the year.

TEEKAY OFFSHORE PARTNERS L.P. AND SUBSIDIARIES
(Successor to Teekay Offshore Partners Predecessor)
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS- (Cont'd)
(all tabular amounts stated in thousands of U.S. dollars, except unit and per unit data or unless otherwise indicated)

17. Change in accounting estimate

Effective January 1, 2008, the Partnership increased its estimate of the residual value of its vessels due to an increase in the estimated scrap rate per lightweight ton from \$150 per lightweight ton to \$325 per lightweight ton. The Partnership's estimate of salvage values took into account the then current scrap prices and the historical scrap rates over the five years prior to December 31, 2007. As a result, depreciation and amortization expense has decreased by \$5.0 million, and net income has increased by \$2.9 million, or \$0.09 per unit, for the year ended December 31, 2008.

18. Discontinued Operations

On July 1, 2006, the Predecessor sold Navion Shipping Ltd. to a subsidiary of Teekay Corporation for \$53.7 million. The resulting gain on sale of \$18.5 million was accounted for as an equity contribution by Teekay Corporation. At the time of the sale, all of the Predecessor's chartered-in conventional tankers were chartered-in by Navion Shipping Ltd. and subsequently time chartered to a subsidiary of Teekay Corporation at charter rates that provided a fixed 1.25% profit margin. These chartered-in conventional tankers were operated in the spot market by the subsidiary of Teekay Corporation.

The loss from discontinued operations of Navion Shipping Ltd. is summarized as follows:

	January 1 to June 30, 2006
Voyage revenues ⁽¹⁾	\$80,014
Loss from discontinued operations before income tax expense	(10,656)
Income tax expense	-
Loss from discontinued operations	\$(10,656)

(1) During the six months ended June 30, 2006 the Predecessor earned \$79.5 million of time charter revenue from a subsidiary of Teekay Corporation pursuant to the agreement with Navion Shipping Ltd.

During the six months ended June 30, 2006, \$10.7 million of general and administrative expenses attributable to the operations of Navion Shipping Ltd. were incurred by Teekay Corporation and have been allocated to Navion Shipping Ltd.

Prior to being reported as discontinued operations, these results were reported within the conventional tanker segment.

19. Subsequent events

(a) In February 2009, the Partnership declared a cash distribution of \$0.45 per unit for the quarter ended December 31, 2008. The cash distribution was paid on February 13, 2009 to all unitholders of record on February 6, 2009.

In May 2009, the Partnership declared a cash distribution of \$0.45 per unit for the quarter ended March 31, 2009. The cash distribution was paid on May 15, 2009 to all unitholders of record on May 8, 2009.

(b) During 2009 the Partnership intends to reflag seven of its vessels from Norwegian flag to Bahamian flag and change the nationality mix of its crews. Under this plan, the Partnership will record and pay the restructuring charges of approximately \$4.4 million during 2009. The actual charges are recorded in the period in which the Partnership commits to a formalized restructuring plan or executes the specific actions contemplated by the program and all criteria for restructuring charge recognition under the applicable accounting guidance have been met. The Partnership expects the reflagging will result in a reduction in its crewing costs for these vessels.

LIST OF SIGNIFICANT SUBSIDIARIES

The following is a list of Teekay Offshore Partners L.P.'s significant subsidiaries as at December 31, 2008:

<u>Name of Significant Subsidiary</u>	<u>State or Jurisdiction of Incorporation</u>	<u>Proportion of Ownership Interest</u>
TEEKAY AUSTRALIA OFFSHORE HOLDINGS PTY LTD.	AUSTRALIA	100.00%
NAVION BERGEN L.L.C.	MARSHALL ISLANDS	100.00%
NAVION GOTHENBURG L.L.C.	MARSHALL ISLANDS	50.00%
NAVION OFFSHORE LOADING AS.	NORWAY	50.99%
NORSK TEEKAY AS.	NORWAY	50.99%
NORSK TEEKAY HOLDINGS LTD.	MARSHALL ISLANDS	50.99%
TEEKAY EUROPEAN HOLDINGS S.A.R.L.	LUXEMBOURG	50.99%
TEEKAY NAVION OFFSHORE LOADING PTE. LTD.	SINGAPORE	50.99%
TEEKAY NETHERLANDS EUROPEAN HOLDINGS BV.	NETHERLANDS	50.99%
TEEKAY NORDIC HOLDINGS INC.	MARSHALL ISLANDS	50.99%
TEEKAY NORWAY AS.	NORWAY	50.99%
TEEKAY OFFSHORE OPERATING L.P.	MARSHALL ISLANDS	50.99%
UGLAND NORDIC SHIPPING AS.	NORWAY	50.99%

CERTIFICATION

I, Peter Evensen, certify that:

1. I have reviewed this Annual Report on Form 20-F of Teekay Offshore Partners, L.P. (the "**Registrant**");
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;
4. I and the Registrant's other certifying officer (which is also myself) are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and
5. I and the Registrant's other certifying officer (which is also myself) have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the board of directors of the Registrant's general partner (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Dated: June 26, 2009

By: /s/ Peter Evensen
Peter Evensen
Chief Executive Officer

CERTIFICATION

I, Peter Evensen, certify that:

1. I have reviewed this Annual Report on Form 20-F of Teekay Offshore Partners, L.P. (the "**Registrant**");
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;
4. I and the Registrant's other certifying officer (which is also myself) are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13(a)-15(e) and 15(d)-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13(a)-15(f) and 15(d)-15(f)) for the Registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting; and
5. I and the Registrant's other certifying officer (which is also myself) have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the board of directors of the Registrant's general partner (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal control over financial reporting.

Dated: June 26, 2009

By: /s/ Peter Evensen
Peter Evensen
Chief Financial Officer

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 906
OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of Teekay Offshore Partners L.P. (the "**Partnership**") on Form 20-F for the year ended December 31, 2008 as filed with the Securities and Exchange Commission on the date hereof (the "**Form 20-F**"), I, Peter Evensen, Chief Executive Officer and Chief Financial Officer of the Partnership, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Form 20-F fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)); and
- (2) The information contained in the Form 20-F fairly presents, in all material respects, the financial condition and results of operations of the Partnership.

Dated: June 26, 2009

By: /s/ Peter Evensen

Peter Evensen

Chief Executive Officer and Chief Financial Officer

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in the Registration Statement (Form S-8 No. 333-147682) pertaining to the Teekay Offshore Partners L.P. 2006 Long Term Incentive Plan and in the Registration Statement (Form F-3 No. 333-150682) and related prospectus of Teekay Offshore Partners L.P. for the registration of up to \$750,000,000 of its common units of our report dated June 24, 2009 with respect to the consolidated financial statements of Teekay Offshore Partners L.P. and its subsidiaries, and our report dated June 24, 2009 on the effectiveness of internal control over financial reporting of Teekay Offshore Partners L.P., and our report dated June 24, 2009 on the consolidated balance sheet of Teekay Offshore GP L.L.C., included in the Annual Report (Form 20-F) for the year ended December 31, 2008.

Vancouver, Canada
June 24, 2009

/s/ ERNST & YOUNG LLP
Chartered Accountants

CONSOLIDATED BALANCE SHEET
OF
TEEKAY OFFSHORE GP L.L.C.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors of
TEEKAY OFFSHORE GP L.L.C.

We have audited the accompanying consolidated balance sheet of Teekay Offshore GP L.L.C. as of December 31, 2008. The balance sheet is the responsibility of the Company's management. Our responsibility is to express an opinion on this consolidated balance sheet based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the balance sheet is free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statement, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated balance sheet referred to above presents fairly, in all material respects, the financial position of Teekay Offshore GP L.L.C. at December 31, 2008 in conformity with U.S. generally accepted accounting principles.

Vancouver, Canada
June 24, 2009

/s/ Ernst & Young LLP
Chartered Accountants

TEEKAY OFFSHORE GP L.L.C. (Note 1)
CONSOLIDATED BALANCE SHEET
(in thousands of U.S. dollars)

	As at December 31, 2008 \$
ASSETS	
Current	
Cash and cash equivalents <i>(note 6)</i>	132,902
Accounts receivable	39,500
Net investment in direct financing leases – current <i>(note 7)</i>	22,941
Prepaid expenses	25,334
Due from affiliates <i>(note 9)</i>	10,110
Other current assets	2,585
Total current assets	233,372
Vessels and equipment <i>(note 6)</i>	
At cost, less accumulated depreciation of \$793,918	1,708,006
Net investment in direct financing leases <i>(note 7)</i>	55,710
Other assets	12,015
Intangible assets – net <i>(note 4)</i>	45,290
Goodwill – shuttle tanker segment	127,113
Total assets	2,181,506
LIABILITIES AND MEMBER'S EQUITY	
Current	
Accounts payable	9,901
Accrued liabilities <i>(note 5)</i>	44,467
Due to affiliate <i>(note 9)</i>	8,819
Current portion of derivative instruments <i>(note 10)</i>	54,937
Current portion of long-term debt <i>(note 6)</i>	125,503
Due to joint venture partners	21,019
Total current liabilities	264,646
Long-term debt <i>(note 6)</i>	1,440,933
Deferred income taxes <i>(note 11)</i>	12,648
Derivative instruments <i>(note 10)</i>	138,374
Other long-term liabilities	21,346
Total liabilities	1,877,947
Commitments and contingencies (notes 6, 7, 10 and 12)	
Non-controlling interest	300,232
Member's equity	
Member's equity	3,668
Accumulated other comprehensive loss	(341)
Total member's equity	3,327
Total liabilities and member's equity	2,181,506

The accompanying notes are an integral part of the Consolidated Balance Sheet.

TEEKAY OFFSHORE GP L.L.C.
NOTES TO THE CONSOLIDATED BALANCE SHEET
(all tabular amounts stated in thousands of U.S. dollars, unless otherwise indicated)

1. Summary of Significant Accounting Policies

Basis of presentation

Teekay Offshore GP L.L.C. (the *Company* or the *General Partner*), a Marshall Islands limited liability company, was formed on August 25, 2006 to become the general partner of Teekay Offshore Partners L.P. (the *Partnership*). The Company is a wholly owned subsidiary of Teekay Corporation. On August 25, 2006, Teekay Corporation contributed \$1,000 to the Company in exchange for a 100% ownership interest. The Company initially invested \$20 in the Partnership for its 2% general partner interest.

During August 2006, Teekay Corporation formed the Partnership, a Marshall Islands limited partnership, as part of its strategy to expand in the marine transportation, processing and storage sectors of the offshore oil industry and for the Partnership to acquire, in connection with the Partnership's initial public offering of its common units, a 26.0% interest in Teekay Offshore Operating L.P. (or *OPCO*), consisting of a 25.99% limited partner interest to be held directly by the Partnership and a 0.01% general partner interest to be held through the Partnership's ownership of Teekay Offshore Operating GP L.L.C., *OPCO's* sole general partner.

Prior to the closing of the Partnership's initial public offering on December 19, 2006, Teekay Corporation transferred eight Aframax conventional crude oil tankers to a subsidiary of Norsk Teekay Holdings Ltd. (or *Norsk Teekay*) and one floating storage and offtake (or *FSO*) unit to Teekay Offshore Australia Trust. Teekay Corporation then transferred to *OPCO* all of the outstanding interests of four wholly-owned subsidiaries — Norsk Teekay, Teekay Nordic Holdings Inc., Teekay Offshore Australia Trust and Pattani Spirit L.L.C. These four wholly-owned subsidiaries, the assets of which include the eight Aframax conventional crude oil tankers and the *FSO* unit, are collectively referred to as *Teekay Offshore Partners Predecessor* or the *Predecessor*.

Immediately prior to the closing of the Partnership's initial public offering, Teekay Corporation sold to the Partnership the 25.99% limited partner interest in *OPCO* and its subsidiaries and a 100% interest in Teekay Offshore Operating GP L.L.C., which owns the 0.01% general partner interest in *OPCO*. In exchange for the equity interests, Teekay Corporation received 2,800,000 common units and 9,800,000 subordinated units from the Partnership and a \$134.6 million non-interest bearing promissory note. The Company received a 2.0% general partner interest and all of the incentive distribution rights in the Partnership. In June 2008 the Partnership purchased from Teekay Corporation an additional 25.0% limited partner interest in *OPCO*. See Note 2.

This consolidated balance sheet has been prepared in conformity with United States generally accepted accounting principles (or *GAAP*). Effective January 1, 2007, we began consolidating the Partnership on a prospective basis in accordance with Emerging Issues Task Force Issue No. 04-5, "Determining Whether a General Partner, of the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights" (EITF 04-5). EITF 04-5 presumes that a general partner controls a limited partnership and therefore should consolidate the partnership in the financial statements of the general partner. Significant intercompany balances and transactions have been eliminated upon consolidation. The preparation of financial statements in conformity with *GAAP* requires management to make estimates and assumptions that affect the amounts reported in the balance sheet and accompanying notes. Actual results may differ from those estimates.

Reporting currency

The consolidated financial statements are stated in U.S. dollars. The functional currency of the Partnership is U.S. dollars because most of the Partnership's shipping revenues are currently earned in U.S. Dollars. Transactions involving other currencies during the year are converted into U.S. dollars using the exchange rates in effect at the time of the transactions. At the balance sheet dates, monetary assets and liabilities that are denominated in currencies other than the U.S. dollar are translated to reflect the year-end exchange rates.

Operating revenues and expenses

The Partnership recognizes revenues from time charters and bareboat charters daily over the term of the charter as the applicable vessel operates under the charter. The Partnership does not recognize revenue during days that the vessel is off-hire. Shuttle tanker voyages servicing contracts of affreightment with offshore oil fields commence with tendering of notice of readiness at a field, within the agreed lifting range, and ends with tendering of notice of readiness at a field for the next lifting. All other voyage revenues from voyage charters are recognized on a percentage of completion method. The Partnership uses a discharge-to-discharge basis in determining percentage of completion for all spot voyages, whereby it recognizes revenue ratably from when product is discharged (unloaded) at the end of one voyage to when it is discharged after the next voyage. The Partnership does not begin recognizing voyage revenue until a charter has been agreed to by the customer and the Partnership, even if the vessel has discharged its cargo and is sailing to the anticipated load port on its next voyage. The consolidated balance sheets reflect the deferred portion of revenues and expenses, which will be earned and incurred, respectively, in subsequent periods. As at December 31, 2008, there was no deferred revenue. As at December 31, 2008, the deferred portion of expenses, which are included in prepaid expenses, was \$14.4 million.

Voyage expenses are all expenses unique to a particular voyage, including bunker fuel expenses, port fees, cargo loading and unloading expenses, canal tolls, agency fees and commissions. Vessel operating expenses include crewing, repairs and maintenance, insurance, stores, lube oils and communication expenses. Voyage expenses and vessel operating expenses are recognized when incurred.

TEEKAY OFFSHORE GP L.L.C.
NOTES TO THE CONSOLIDATED BALANCE SHEET – (Cont'd)
(all tabular amounts stated in thousands of U.S. dollars, unless otherwise indicated)

Cash and cash equivalents

The Partnership classifies all highly liquid investments with an original maturity date of three months or less when purchased as cash and cash equivalents.

Accounts receivable and allowance for doubtful accounts

Accounts receivable are recorded at the invoiced amount and do not bear interest. The allowance for doubtful accounts is the Partnership's best estimate of the amount of probable credit losses in existing accounts receivable. The Partnership determines the allowance based on historical write-off experience and customer economic data. The Partnership reviews the allowance for doubtful accounts regularly and past due balances are reviewed for collectability. Account balances are charged off against the allowance when the Partnership believes that the receivable will not be recovered.

Vessels and equipment

All pre-delivery costs incurred during the construction of newbuildings, including interest, supervision and technical costs, are capitalized. The acquisition cost and all costs incurred to restore used vessels purchased by the Partnership to the standards required to properly service the Partnership's customers are capitalized.

Depreciation is calculated on a straight-line basis over a vessel's estimated useful life, less an estimated residual value. Depreciation is calculated using an estimated useful life of 25 years, commencing from the date the vessel is delivered from the shipyard, or a shorter period if regulations prevent the Partnership from operating the vessel for 25 years.

Vessel capital modifications include the addition of new equipment or can encompass various modifications to the vessel which are aimed at improving and/or increasing the operational efficiency and functionality of the asset. This type of expenditure is amortized over the estimated useful life of the modification. Expenditures covering recurring routine repairs or maintenance are expensed as incurred.

Generally, the Partnership drydocks each shuttle tanker and conventional oil tanker every two and a half to five years. FSO units are generally not drydocked. The Partnership capitalizes a substantial portion of the costs incurred during drydocking and amortizes those costs on a straight-line basis from the completion of a drydocking to the estimated completion of the next drydocking. The Partnership includes in capitalized drydocking those costs incurred as part of the drydocking to meet regulatory requirements, or are expenditures that either add economic life to the vessel, increase the vessel's earnings capacity or improve the vessel's efficiency. The Partnership expenses as incurred costs related to routine repairs and maintenance performed during drydocking that do not improve or extend the useful lives of the assets. When significant drydocking expenditures occur prior to the expiration of the original amortization period, the remaining unamortized balance of the original drydocking cost are expensed in the month of the subsequent drydocking.

Drydocking activity for the year ended December 31, 2008 is summarized as follows:

	Year Ended December 31, 2008
	\$
Balance at beginning of period	71,910
Cost incurred for drydocking	26,944
Drydock amortization	(22,235)
Balance at end of period	76,619

Vessels and equipment that are "held and used" are assessed for impairment when events or circumstances indicate the carrying amount of the asset may not be recoverable. If the asset's net carrying value exceeds the net undiscounted cash flows expected to be generated over its remaining useful life, the carrying amount of the asset is reduced to its estimated fair value. Estimated fair value is determined based on discounted cash flows or appraised values depending on the nature of the asset.

Direct financing leases

The Partnership assembles, installs, operates and leases equipment that reduces volatile organic compound emissions (or *VOC equipment*) during loading, transportation and storage of oil and oil products. Leasing of the VOC equipment is accounted for as a direct financing lease with lease payments received by the Partnership being allocated between the net investment in the lease and other income using the effective interest method so as to produce a constant periodic rate of return over the lease term.

TEEKAY OFFSHORE GP L.L.C.
NOTES TO THE CONSOLIDATED BALANCE SHEET – (Cont'd)
(all tabular amounts stated in thousands of U.S. dollars, unless otherwise indicated)

Investment in joint ventures

Investments in companies over which the Partnership exercises significant influence, are accounted for using the equity method, whereby the investment is carried at the Partnership's original cost plus its proportionate share of undistributed earnings. The excess carrying value of the Partnership's investment over its underlying equity in the net assets is included in the consolidated balance sheet as investment in joint ventures. On December 1, 2006, the operating agreements for the five 50%-owned joint ventures, each of which owns one shuttle tanker, were amended. These amendments resulted in the Partnership obtaining control of these entities and, consequently, the Partnership has consolidated these entities effective December 1, 2006. As at December 31, 2008, the Partnership had a 50% interest in six subsidiaries.

Debt issuance costs

Debt issuance costs, including fees, commissions and legal expenses, are presented as other assets and capitalized and amortized on a straight-line basis over the term of the relevant loan. Amortization of debt issuance costs is included in interest expense.

Goodwill and intangible assets

Goodwill is not amortized, but reviewed for impairment annually or more frequently if impairment indicators arise. A fair value approach is used to identify potential goodwill impairment and, when necessary, measure the amount of impairment. The Partnership uses a discounted cash flow model to determine the fair value of reporting units, unless there is a readily determinable fair market value. Intangible assets are assessed for impairment when and if impairment indicators exist. An impairment loss is recognized if the carrying amount of an intangible asset is not recoverable and its carrying amount exceed its fair value.

The Partnership's intangible assets, which consist of contracts of affreightment acquired as part of the Predecessor's purchase of Navion AS in 2003, are amortized over their respective lives, with the amount amortized each year being weighted based on the projected revenue to be earned under the contracts.

Derivative instruments

All derivative instruments are initially recorded at cost as either assets or liabilities in the accompanying consolidated balance sheet and subsequently remeasured to fair value, regardless of the purpose or intent for holding the derivative. The method of recognizing the resulting gain or loss is dependent on whether the derivative contract is designed to hedge a specific risk and also qualifies for hedge accounting. The Partnership generally does not designate its interest rate swap agreements as cash flow hedges for accounting purposes. The Partnership generally designates foreign currency forward contracts as cash flow hedges for accounting purposes. (Please see Note 10.)

When a derivative is designated as a cash flow hedge, the Partnership formally documents the relationship between the derivative and the hedged item. This documentation includes the strategy and risk management objective for undertaking the hedge and the method that will be used to assess the effectiveness of the hedge. Any hedge ineffectiveness is recognized immediately in earnings, as are any gains and losses on the derivative that are excluded from the assessment of hedge effectiveness. The Partnership does not apply hedge accounting if it is determined that the hedge was not effective or will no longer be effective, the derivative was sold or exercised, or the hedged item was sold, repaid or no longer possible of occurring.

For derivative financial instruments designated and qualifying as cash flow hedges, changes in the fair value of the effective portion of the derivative financial instruments are initially recorded as a component of accumulated other comprehensive income in partners' equity. In the periods when the hedged items affect earnings, the associated fair value changes on the hedging derivatives are transferred from partners' equity to the corresponding earnings line item. The ineffective portion of the change in fair value of the derivative financial instruments is immediately recognized in earnings. If a cash flow hedge is terminated and the originally hedged items may still possibly affect earnings, the gains and losses initially recognized in partners' equity remain until the hedged item impacts earnings, at which point they are transferred to the corresponding earnings line item. If the hedged items may no longer affect earnings, amounts recognized in partners' equity are immediately transferred to earnings.

For derivative financial instruments that are not designated or that do not qualify as hedges under Statement of Financial Accounting Standards (or SFAS) No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended, the changes in the fair value of the derivative financial instruments are recognized in earnings.

Gains and losses from the Partnership's non-designated interest rate swaps related to long-term debt are recorded in interest expense. Gains and losses from the Partnership's foreign currency forward contracts are recorded within operating expenses, based on the nature of the expense being hedged.

Income taxes

The Partnership's Norwegian subsidiaries and Australian subsidiary are subject to income taxes. The Partnership accounts for such taxes using the liability method pursuant to SFAS No. 109, *Accounting for Income Taxes*.

In July 2006, the Financial Accounting Standards Board (or FASB) issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109* (or FIN 48). This interpretation clarifies the accounting for uncertainty in income taxes recognized in financial statements in accordance with SFAS 109. FIN 48 requires companies to determine whether it is more-likely-than-not that a tax position taken or expected to be taken in a tax return will be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. If a tax position meets the more-likely-than-not recognition threshold, it is measured to determine the amount of benefit to recognize in the financial statements based on guidance in the interpretation.

TEEKAY OFFSHORE GP L.L.C.
NOTES TO THE CONSOLIDATED BALANCE SHEET – (Cont'd)
(all tabular amounts stated in thousands of U.S. dollars, unless otherwise indicated)

The Partnership adopted FIN 48 as of January 1, 2007. The adoption of FIN 48 did not have a significant impact on the Partnership's financial position and results of operations. As of December 31, 2008, the Partnership did not have any material unrecognized tax benefits or material accrued interest and penalties relating to taxes. The Partnership does not expect any material changes to its unrecognized tax positions within the next twelve months.

The Partnership recognizes interest and penalties related to uncertain tax positions in income tax expense. The 2006, 2007, and 2008 tax years remain open to examination by the Australian and Norwegian taxing jurisdictions to which the Partnership is subject.

Recent Accounting Pronouncements

In April 2009, the Financial Accounting Standards Board (or FASB) issued Statement of Financial Accounting Standards (or SFAS) 115-2 and SFAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*. This statement changes existing accounting requirements for other-than-temporary impairment. SFAS 115-2 is effective for interim and annual periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. The Partnership is currently evaluating the potential impact, if any, of the adoption of SFAS 115-2 on its consolidated results of operations and financial condition.

In April 2009, the FASB issued SFAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability has Significantly Decreased and Identifying Transactions that are Not Orderly*. SFAS 157-4 amends SFAS 157, *Fair Value Measurements* to provide additional guidance on estimating fair value when the volume and level of transaction activity for an asset or liability have significantly decreased in relation to normal market activity for the asset or liability. SFAS 157-4 also provides additional guidance on circumstances that may indicate that a transaction is not orderly. SFAS 157-4 supersedes SFAS 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active*. The guidance in SFAS 157-4 is effective for interim and annual reporting periods ending after June 15, 2009. Early adoption is permitted, but only for periods ending after March 15, 2009. The Partnership is currently evaluating the potential impact, if any, of the adoption of SFAS 157-4 on its consolidated results of operations and financial condition.

In April 2009, the FASB issued SFAS 107-1 and APB 28-1, *Interim Disclosures About Fair Value of Financial Instruments*. SFAS 107-1 extends the disclosure requirements of SFAS 107, *Disclosures about Fair Value of Financial Instruments* to interim financial statements of publicly traded companies as defined in APB Opinion No. 28, *Interim Financial Reporting*. SFAS 107-1 is effective for interim reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. The Partnership is currently evaluating the potential impact, if any, of the adoption of SFAS 107-1 on its consolidated results of operations and financial condition.

In April 2009, the FASB issued SFAS 141(R)-1, *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination that Arise from Contingencies*. This statement amends SFAS 141, *Business Combinations*, to require that assets acquired and liabilities assumed in a business combination that arise from contingencies be recognized at fair value, in accordance with SFAS 157, if the fair value can be determined during the measurement period. SFAS 141(R)-1 is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Partnership is currently evaluating the potential impact, if any, of the adoption of SFAS 141(R)-1 on its consolidated results of operations and financial condition.

In October 2008, FASB issued SFAS No. 157-3, *Determining the Fair Value of a Financial Asset in a Market That Is Not Active*, which clarifies the application of SFAS 157 when the market for a financial asset is inactive. Specifically, SFAS No. 157-3 clarifies how (1) management's internal assumptions should be considered in measuring fair value when observable data are not present, (2) observable market information from an inactive market should be taken into account, and (3) the use of broker quotes or pricing services should be considered in assessing the relevance of observable and unobservable data to measure fair value. The guidance in SFAS No. 157-3 is effective immediately but does not have any impact on the Partnership's consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161: *Disclosures about Derivative Instruments and Hedging Activities, an amendment of Statement of Financial Accounting Standards No. 133 (or SFAS 161)*. The statement requires qualitative disclosures about an entity's objectives and strategies for using derivatives and quantitative disclosures about how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows. SFAS 161 is effective for fiscal years, and interim periods within those fiscal years, beginning after November 15, 2008, with early application allowed. SFAS 161 allows but does not require, comparative disclosures for earlier periods at initial adoption.

In December 2007, the FASB issued SFAS No. 141(R): *Business Combinations (or SFAS 141(R))*, which replaces SFAS No. 141, *Business Combinations*. This statement establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired. SFAS 141(R) also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS 141(R) is effective for fiscal years beginning after December 15, 2008. The Partnership is currently evaluating the potential impact, if any, of the adoption of SFAS 141(R) on its consolidated results of operations and financial condition.

In December 2007, the FASB issued SFAS No. 160: *Noncontrolling Interests in Consolidated Financial Statements, an Amendment of Accounting Research Bulletin No. 51 (or SFAS 160)*. This statement establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent's ownership interest, and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. SFAS 160 also establishes disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS 160 is effective for fiscal years beginning after December 15, 2008. The Partnership is currently evaluating the potential impact, if any, of the adoption of SFAS 160 on its consolidated results of operations and financial condition.

TEEKAY OFFSHORE GP L.L.C.
NOTES TO THE CONSOLIDATED BALANCE SHEET – (Cont'd)
(all tabular amounts stated in thousands of U.S. dollars, unless otherwise indicated)

2. Public Offerings

On December 19, 2006, the Partnership completed its initial public offering (or the *Offering*) of 8.05 million common units at a price of \$21.00 per unit. This included 1.05 million common units sold to the underwriters in connection with the exercise of their over-allotment option. The proceeds received by the Partnership from the Offering and the use of those proceeds are summarized as follows:

Proceeds received:

Sale of 8,050,000 common units at \$21.00 per unit	\$169,050
--	-----------

Use of proceeds from sale of common units:

Underwriting and structuring fees	\$11,088
Professional fees and other offering expenses to third parties	2,793
Repayment of promissory notes and redemption of 1.05 million common units from Teekay Corporation	155,169
	\$169,050

On June 18, 2008, the Partnership completed a follow-on public offering (or the *Follow-on Offering*) of 7.0 million common units at a price of \$20.00 per unit, for gross proceeds of \$140.0 million. Concurrently with the public offering, Teekay Corporation, which controls the Partnership, acquired 3.25 million common units of the Partnership in a private placement at the same public offering price for a total cost of \$65.0 million. On July 16, 2008, the underwriters for the public offering partially exercised their over-allotment option and purchased an additional 375,000 common units for an additional \$7.5 million in gross proceeds to the Partnership.

As a result of these equity transactions, the Partnership raised gross proceeds of \$216.8 million (including the Company's proportionate 2% capital contribution), and Teekay Corporation's ownership of the Partnership was reduced from 59.8% to 50.0% (including its indirect 2% general partner interest). The Partnership used the net proceeds from the equity offerings of approximately \$210.7 million to fund the acquisition of an additional 25% interest in Teekay Offshore Operating L.P. (or *OPCO*) from Teekay Corporation and to repay a portion of advances to the Partnership from *OPCO*.

3. Segment Reporting

The Partnership is engaged in the international transportation of crude oil through the operation of its oil tankers and FSO units. The Partnership's revenue is earned in international markets.

The Partnership has three reportable segments: its shuttle tanker segment; its conventional tanker segment; and its FSO segment. The Partnership's shuttle tanker segment consists of shuttle tankers operating primarily on fixed-rate contracts of affreightment, time-charter contracts or bareboat charter contracts. The Partnership's conventional tanker segment consists of conventional tankers operating on fixed-rate time-charter contracts or bareboat charter contracts. The Partnership's FSO segment consists of its FSO units subject to fixed-rate time-charter contracts or bareboat charter contracts. Segment results are evaluated based on income from vessel operations. The accounting policies applied to the reportable segments is the same as those used in the preparation of the Partnership's consolidated financial statements.

A reconciliation of total segment assets to total assets presented in the accompanying consolidated balance sheets is as follows:

	December 31, 2008
	\$
Shuttle tanker segment	1,517,961
Conventional tanker segment	332,795
FSO segment	108,304
Unallocated	
Cash and cash equivalents	132,902
Accounts receivable and other assets	89,544
Consolidated total assets	2,181,506

4. Intangible Assets

As at December 31, 2008, intangible assets consisted of:

	December 31, 2008		
Weighted-Average Amortization Period (years)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
	\$	\$	\$
Contracts of affreightment	10.2	124,250	(78,960)
		45,290	

Amortization of intangible assets for the five years subsequent to December 31, 2008 is expected to be \$9.1 million (2009), \$8.1 million (2010), \$7.0 million (2011), \$6.0 million (2012) and \$5.0 million (2013).

TEEKAY OFFSHORE GP L.L.C.
NOTES TO THE CONSOLIDATED BALANCE SHEET – (Cont'd)
(all tabular amounts stated in thousands of U.S. dollars, unless otherwise indicated)

5. Accrued Liabilities

	December 31, 2008
	\$
Voyage and vessel	31,162
Interest	11,994
Payroll and benefits	1,311
	44,467

6. Long-Term Debt

	December 31, 2008
	\$
U.S. Dollar-denominated Revolving Credit Facilities due through 2017	1,314,264
U.S. Dollar-denominated Term Loans due through 2017	252,172
	1,566,436
Less current portion	125,503
Total	1,440,933

As at December 31, 2008, the Partnership had seven long-term revolving credit facilities (collectively the *Revolvers*), which, as at such date, provided for borrowings of up to \$1.46 billion, of which \$142.7 million was undrawn. The total amount available under the revolving credit facilities reduces by \$126.1 million (2009), \$132.8 million (2010), \$140.0 million (2011), \$147.6 million (2012), \$169.6 million (2013) and \$740.9 million (thereafter). Five of the revolving credit facilities are guaranteed by certain subsidiaries of the Partnership for all outstanding amounts and contain covenants that require OPCO to maintain the greater of a minimum liquidity (cash, cash equivalents and undrawn committed revolving credit lines with at least six months to maturity) of at least \$75.0 million and 5.0% of OPCO's total consolidated debt. The remaining revolving credit facilities are guaranteed by Teekay Corporation and contain covenants that require Teekay Corporation to maintain the greater of a minimum liquidity of at least \$50.0 million and 5.0% of Teekay Corporation's total consolidated debt which has recourse to Teekay Corporation. The revolving credit facilities are collateralized by first-priority mortgages granted on 33 of the Partnership's vessels, together with other related security.

As at December 31, 2008, five of the Partnership's six 50% owned subsidiaries had an outstanding term loan, which in the aggregate totaled \$252.2 million. The term loans have varying maturities through 2017 and semi-annual payments that reduce over time. All term loans are collateralized by first-priority mortgages on the vessels to which the loans relate, together with other related security. As at December 31, 2008, the Partnership had guaranteed \$76.0 million of these term loans, which represents its 50% share of the outstanding vessel mortgage debt of five of these 50% owned subsidiaries. The other owner and Teekay Corporation have guaranteed the remaining \$176.2 million.

Interest payments on the revolving credit facilities and the term loans are based on LIBOR plus a margin. At December 31, 2008, the margins ranged between 0.45% and 0.95%. The weighted-average effective interest rate on the Partnership's long-term debt as at December 31, 2008 was 3.4%. This rate does not reflect the effect of our interest rate swaps (Note 10).

The aggregate annual long-term debt principal repayments required to be made subsequent to December 31, 2008 are \$125.5 million (2009), \$134.7 million (2010), \$169.3 million (2011), \$147.1 million (2012), \$155.4 million (2013), and \$834.4 million (thereafter).

7. Leases

Charters-out and Direct Financing Lease

Time charters and bareboat charters of the Partnership's vessels to customers are accounted for as operating leases. The carrying amount of the vessels employed on operating leases at December 31, 2008 was \$1.3 billion (2007 - \$1.3 billion). Leasing of the VOC equipment is accounted for as direct financing leases. As at December 31, 2008, the minimum lease payments receivable under the direct financing leases approximated \$94.5 million, including unearned income of \$15.9 million.

As at December 31, 2008, minimum scheduled future revenues under time charters and bareboat charters and future scheduled payments under the direct financing leases, to be received by the Partnership, then in place were approximately \$1.6 billion, comprised of \$376.4 million (2009), \$268.1 million (2010), \$194.4 million (2011), \$158.3 million (2012), \$133.5 million (2013) and \$468.4 million (thereafter).

The minimum scheduled future revenues should not be construed to reflect total charter hire revenues for any of the years. In addition, minimum scheduled future revenues have been reduced by estimated off-hire time for period maintenance.

Charters-in

As at December 31, 2008, minimum commitments owing by the Partnership under vessel operating leases by which the Partnership charters-in vessels were approximately \$393.9 million, comprised of \$109.8 million (2009), \$88.6 million (2010), \$62.9 million (2011), \$56.8 million (2012), \$46.8 million (2013) and \$29.0 million (thereafter). The Partnership recognizes the expense from these charters, which is included in time-charter hire expense, on a straight-line basis over the firm period of the charters.

TEEKAY OFFSHORE GP L.L.C.
NOTES TO THE CONSOLIDATED BALANCE SHEET – (Cont'd)
(all tabular amounts stated in thousands of U.S. dollars, unless otherwise indicated)

8. Fair Value of Measurements

Effective January 1, 2008, the Partnership adopted SFAS No. 157, *Fair Value Measurements*. In accordance with Financial Accounting Standards Board Staff Position No. FAS 157-2, *Effective Date of FASB Statement No. 157*, the Partnership deferred the adoption of SFAS No. 157 for its nonfinancial assets and nonfinancial liabilities, except those items recognized or disclosed at fair value on an annual or more frequently recurring basis, until January 1, 2009. The adoption of SFAS No. 157 did not have a material impact on the Partnership's fair value measurements.

SFAS No. 157 clarifies the definition of fair value, prescribes methods for measuring fair value, establishes a fair value hierarchy based on the inputs used to measure fair value and expands disclosure about the use of fair value measurements. The fair value hierarchy has three levels based on the reliability of the inputs used to determine fair value as follows:

- Level 1. Observable inputs such as quoted prices in active markets;
- Level 2. Inputs, other than the quoted prices in active markets, that are observable either directly or indirectly; and
- Level 3. Unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

The following methods and assumptions were used to estimate the fair value of each class of financial instrument:

Cash and cash equivalents - The fair value of the Partnership's cash and cash equivalents approximate their carrying amounts reported in the accompanying consolidated balance sheets.

Due to / from affiliates – The fair value of the amounts due to and from affiliates approximate their carrying amounts reported in the accompanying consolidated balance sheets.

Long-term debt – The fair values of the Partnership's fixed-rate and variable-rate long-term debt are either based on quoted market prices or estimated using discounted cash flow analyses, based on rates currently available for debt with similar terms and remaining maturities and the current credit worthiness of the Partnership.

Due to joint venture partners – The fair value of the Partnership's loans from joint venture partners approximate their carrying amounts reported in the accompanying consolidated balance sheets.

Derivative instruments – The fair value of the Partnership's derivative instruments is the estimated amount that the Partnership would receive or pay to terminate the agreements at the reporting date, taking into account current interest rates, foreign exchange rates and the current credit worthiness of both the Partnership and the derivative counterparties. The estimated amount is the present value of future cash flows. Given the current volatility in the credit markets, it is reasonably possible that the amount recorded as a derivative liability could vary by a material amount in the near term.

The estimated fair value of the Partnership's financial instruments is as follows:

	Fair Value Hierarchy Level	December 31, 2008	
		Carrying Amount \$	Fair Value \$
Cash and cash equivalents	-	132,902	132,902
Due from affiliate (note 9g)	-	10,110	10,110
Due to affiliate (note 9g)	-	(8,819)	(8,819)
Long-term debt	Level 2	(1,566,436)	(1,476,608)
Due to joint venture partners	-	(21,019)	(21,019)
Derivative instruments ⁽¹⁾ (note 10)			
Interest rate swap agreements	Level 2	(159,169)	(159,169)
Foreign currency forward contracts	Level 2	(37,554)	(37,554)

(1) The Partnership transacts all of its derivative instruments through investment-grade rated financial institutions at the time of the transaction and requires no collateral from these institutions.

(2) The fair value of the Partnership's interest rate swap agreements includes \$3.4 million of accrued interest which is recorded in accrued liabilities on the balance sheet.

9. Related Party Transactions

- a. The Partnership has entered into an omnibus agreement with Teekay Corporation, Teekay LNG Partners L.P., the Company and others governing, among other things, when the Partnership, Teekay Corporation and Teekay LNG Partners L.P. may compete with each other and certain rights of first offering on liquefied natural gas carriers, oil tankers, shuttle tankers, FSO units and floating production, storage and offloading units.
- b. In March 2008, Teekay Corporation agreed to reimburse the Partnership for repair costs relating to one of the Partnership's shuttle tankers. The vessel was purchased from Teekay Corporation in July 2007 and had, as of the date of acquisition, an inherent minor defect that required repairs. Pursuant to this agreement, Teekay Corporation reimbursed \$0.7 million of these costs during the year ended December 31, 2008.

TEEKAY OFFSHORE GP L.L.C.
NOTES TO THE CONSOLIDATED BALANCE SHEET – (Cont'd)
(all tabular amounts stated in thousands of U.S. dollars, unless otherwise indicated)

- c. In March 2008, a subsidiary of OPCO sold certain vessel equipment to a subsidiary of Teekay Corporation for proceeds equal to its net book value of \$1.4 million.
- d. Concurrently with the closing of the Partnership's Follow-on Offering, the Partnership acquired from Teekay Corporation an additional 25% interest in OPCO for \$205.5 million, thereby increasing the Partnership's ownership interest in OPCO to 51%. The Partnership financed the acquisition with the net proceeds from the Follow-on Offering and a concurrent private placement of common units to Teekay Corporation. See Note 2. In connection with the valuation of the purchase of the additional 25% interest in OPCO, the Partnership incurred a fairness opinion fee of \$1.1 million. The excess of the proceeds paid by the Partnership over Teekay Corporation's historical book value for the 25% interest in OPCO was accounted for as an equity distribution to Teekay Corporation of \$91.6 million.
- e. On June 18, 2008, OPCO acquired from Teekay Corporation two ship owning subsidiaries (SPT Explorer L.L.C. and the SPT Navigator L.L.C.) for a total cost of approximately \$106.0 million, including the assumption of third-party debt of approximately \$89.3 million and the non-cash settlement of related party working capital of \$1.2 million. The acquired subsidiaries own two 2008-built Aframax lightering tankers (the *SPT Explorer* and the *SPT Navigator*) and their related 10-year, fixed-rate bareboat charters (with options exercisable by the charterer to extend up to an additional five years) entered into with Skaugen PetroTrans, a joint venture in which Teekay Corporation owns a 50% interest. These two lightering tankers are specially designed to be used in ship-to-ship oil transfer operations. This purchase was financed with the assumption of debt, together with cash balances. The excess of the proceeds paid by the Partnership over Teekay Corporation's historical book value was accounted for as an equity distribution to Teekay Corporation of \$16.2 million. Pursuant to the bareboat charters for the vessels, OPCO earned voyage revenues of \$8.7 million for the year ended December 31, 2008 (including voyage revenues earned as part of the Dropdown Predecessor prior to OPCO's acquisition of the vessels – see Note 1).
- f. In June 2008, Teekay Corporation agreed to reimburse OPCO for certain costs relating to events which occurred prior to the Partnership's Offering in December 2006, totalling \$0.7 million, primarily relating to the settlement of repair costs not covered by insurance providers for work performed in early 2006 on two of OPCO's shuttle tankers.
- g. At December 31, 2008, due from affiliates totaled \$10.1 million and due to affiliates totaled \$8.8 million. Due to and from affiliate are non-interest bearing and unsecured.

10. Derivative Instruments and Hedging Activities

The Partnership uses derivatives in accordance with its overall risk management policies. The following summarizes the Partnership's risk strategies with respect to market risk from foreign currency fluctuations and changes in interest rates.

The Partnership hedges portions of its forecasted expenditures denominated in foreign currencies with foreign currency forward contracts. These foreign currency forward contracts are generally designated, for accounting purposes, as cash flow hedges of forecasted foreign currency expenditures. Where such instruments are designated and qualify as cash flow hedges, the effective portion of the changes in their fair value is recorded in accumulated other comprehensive income (loss), until the hedged item is recognized in earnings. At such time, the respective amount in accumulated other comprehensive income (loss) is released to earnings and is recorded within operating expenses, based on the nature of the expense being economically hedged.

Changes in fair value of foreign currency forward contracts that are not designated, for accounting purposes, as cash flow hedges are recognized in earnings and are reported in operating expenses, based on the nature of the expense being hedged.

During the year ended December 31, 2008, the Partnership reclassified \$0.3 million from accumulated other comprehensive income to general and administrative expenses, on the discontinuation of hedge accounting for certain foreign currency forward contracts, where the forecasted transactions were no longer deemed to be probable of occurring.

As at December 31, 2008, the Partnership was committed to the following foreign currency forward contracts:

	Contract Amount in Foreign Currency (thousands)	Fair Value / Carrying Amount of Liability (thousands of U.S. Dollars)	Average Forward Rate ⁽¹⁾	Expected Maturity 2009 2010 (in thousands of U.S. Dollars)	
Norwegian Kroner	1,228,764	\$35,157	5.83	\$114,718	\$96,068
Australian Dollar	3,300	646	1.12	2,952	-
British Pound	443	199	0.52	750	100
Euro	24,725	1,552	0.69	23,702	12,254
		<u>\$37,554</u>		<u>\$142,122</u>	<u>\$108,422</u>

(1) Average forward rate represents the contracted amount of foreign currency one U.S. Dollar will buy.

As at December 31, 2008, the Company's accumulated other comprehensive loss included \$17.0 million of unrealized losses on foreign currency forward contracts designated as cash flow hedges. As at December 31, 2008, the Company estimated, based on then current foreign exchange rates, that it would reclassify approximately \$11.6 million of net losses on foreign currency forward contracts from accumulated other comprehensive loss to earnings during the next 12 months.

TEEKAY OFFSHORE GP L.L.C.
NOTES TO THE CONSOLIDATED BALANCE SHEET – (Cont'd)
(all tabular amounts stated in thousands of U.S. dollars, unless otherwise indicated)

The Partnership enters into interest rate swaps which exchange a receipt of floating interest for a payment of fixed interest to reduce the Partnership's exposure to interest rate variability on its outstanding floating rate debt. The Partnership has not designated, for accounting purposes, its interest rate swaps as cash flow hedges of its USD LIBOR-denominated borrowings. Unrealized gains or losses relating to the change in fair value of the Partnership's interest rate swaps have been reported in interest expense in the consolidated statements of income (loss).

As at December 31, 2008, the Partnership was committed to the following interest rate swap agreements:

	Interest Rate Index	Principal Amount \$	Fair Value / Carrying Amount of Liability \$	Weighted-Average Remaining Term (Years)	Fixed Interest Rate (%) ⁽¹⁾
U.S. Dollar-denominated interest rate swaps	LIBOR	935,000	88,580	5.5	4.7
U.S. Dollar-denominated interest rate swaps ⁽²⁾	LIBOR	397,279	70,589	12.4	5.0
		1,332,279	159,169		

(1) Excludes the margin the Partnership pays on its variable-rate debt, which as at December 31, 2008, ranged from 0.45% and 0.95%.

(2) Principal amount reduces quarterly or semi-annually.

(3) The fair value of the Partnership's interest rate swap agreements includes \$3.4 million of accrued interest which is recorded in accrued liabilities on the balance sheet.

The Partnership is exposed to credit loss in the event of non-performance by the counter-parties to the foreign currency forward contracts and the interest rate swap agreements. In order to minimize counterparty risk, the Partnership only enters into derivative transactions with counterparties that are rated A or better by Standard & Poor's or Aa3 or better by Moody's at the time of the transactions. In addition, to the extent possible and practical, interest rate swaps are entered into with different counterparties to reduce concentration risk.

11. Income Taxes

The significant components of the Partnership's deferred tax liabilities and assets are as follows:

	December 31, 2008 \$
Deferred tax liabilities:	
Vessels and equipment	50,231
Goodwill and intangible assets	-
Long-term debt	11,505
Total deferred tax liabilities	61,736
Deferred tax assets:	
Other	1,521
Tax losses carried forward ⁽¹⁾	47,567
Total deferred tax assets	49,088
Net deferred tax liabilities	12,648
Current portion	-
Long-term portion of net deferred tax liabilities	12,648

(1) The net operating loss carry forwards of \$169.0 million are available to offset future taxable income in the applicable jurisdictions, and can be carried forward indefinitely.

(2) The change in the net deferred tax liabilities is related to the change in temporary differences and foreign exchange gains.

12. Commitments and Contingencies

The Partnership may, from time to time, be involved in legal proceedings and claims that arise in the ordinary course of business. The Partnership believes that any adverse outcome, individually or in the aggregate, of any existing claims would not have a material affect on its financial position, results of operations or cash flows, when taking into account its insurance coverage and indemnifications from charterers or Teekay Corporation.

13. Subsequent Events

(a) In February 2009, the Partnership declared a cash distribution of \$0.45 per unit for the quarter ended December 31, 2008. The cash distribution was paid on February 13, 2009 to all unitholders of record on February 6, 2009.

In May 2009, the Partnership declared a cash distribution of \$0.45 per unit for the quarter ended March 31, 2009. The cash distribution was paid on May 15, 2009 to all unitholders of record on May 8, 2009.

TEEKAY OFFSHORE GP L.L.C.
NOTES TO THE CONSOLIDATED BALANCE SHEET – (Cont'd)
(all tabular amounts stated in thousands of U.S. dollars, unless otherwise indicated)

(b) During 2009 the Partnership intends to reflag seven of its vessels from Norwegian flag to Bahamian flag and change the nationality mix of its crews. Under this plan, the Partnership will record and pay the restructuring charges of approximately \$4.4 million during 2009. The actual charges are recorded in the period in which the Partnership commits to a formalized restructuring plan or executes the specific actions contemplated by the program and all criteria for restructuring charge recognition under the applicable accounting guidance have been met. The Partnership expects the reflagging will result in a reduction in its crewing costs for these vessels.

14. Supplemental information

The following balance sheet shows the consolidation of the Teekay Offshore GP L.L.C. balance sheet on a stand-alone basis with the balance sheet of Teekay Offshore Partners L.P., as of December 31, 2008.

	Teekay Offshore G.P. L.L.C Stand-alone	Consolidation of Teekay Offshore Partners L.P.	Teekay Offshore G.P. L.L.C Consolidated
ASSETS			
Current			
Cash and cash equivalents	1,414	131,488	132,902
Accounts receivable	-	39,500	39,500
Net Investment in direct financing leases	-	22,941	22,941
Prepaid expenses	-	25,334	25,334
Due from affiliates	-	10,110	10,110
Other current assets	-	2,585	2,585
Total current assets	1,414	231,958	233,372
Vessels and equipment	-	1,708,006	1,708,006
Net investment in direct financing leases	-	55,710	55,710
Other assets	-	12,015	12,015
Intangible assets – net	-	45,290	45,290
Goodwill	-	127,113	127,113
Total assets	1,414	2,180,092	2,181,506
LIABILITIES AND MEMBER'S EQUITY			
Current			
Accounts payable	-	9,901	9,901
Accrued liabilities	-	44,467	44,467
Due to affiliate	104	8,715	8,819
Current portion of derivative instruments	-	54,937	54,937
Current portion of long-term debt	-	125,503	125,503
Due to joint venture partners	-	21,019	21,019
Total current liabilities	104	264,542	264,646
Long-term debt	-	1,440,933	1,440,933
Deferred income taxes	-	12,648	12,648
Derivative instruments	-	138,374	138,374
Other long-term liabilities	-	21,346	21,346
Total liabilities	104	1,877,843	1,877,947
Non-controlling interest	-	300,232	300,232
Member's equity			
Member's equity	1,310	2,358	3,668
Accumulated other comprehensive loss	-	(341)	(341)
Total member's equity	1,310	2,017	3,327
Total liabilities and member's equity	1,414	2,180,092	2,181,506