Teekay Offshore Partners L.P.
Form 6-K
August 25, 2011

Table of Contents

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

FORM 6-K
Report of Foreign Private Issuer
Pursuant to Rule 13a-16 or 15d-16 of
the Securities Exchange Act of 1934

For the quarterly period ended June 30, 2011
Commission file number 1- 33198
TEEKAY OFFSHORE PARTNERS L.P.
(Exact name of Registrant as specified in its charter)
4th Floor, Belvedere Building, 69 Pitts Bay Road, Hamilton, HM 08, Bermuda
(Address of principal executive office)

Indicate by check mark whether the registrant files or will file annual reports under cover Form 20-F or Form 40-F.
Form 20-F þ Form 40- F o
Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(1).
Yes o No þ
Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(7).
Yes o No þ

TEEKAY OFFSHORE PARTNERS L.P. AND SUBSIDIARIES
REPORT ON FORM 6-K FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2011
INDEX

Table of Contents

ITEM 1 FINANCIAL STATEMENTS
TEEKAY OFFSHORE PARTNERS L.P. AND SUBSIDIARIES (Note 1)
UNAUDITED CONSOLIDATED STATEMENTS OF (LOSS) INCOME
(in thousands of U.S. dollars, except unit and per unit data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	**2010**	**2011**	**2010**
	$	**$**	**$**	**$**
REVENUES *(note 9d)*	234,145	226,838	467,916	460,417
OPERATING EXPENSES				
Voyage expenses	32,572	34,949	58,037	69,903
Vessel operating expenses *(note 9d, 10)*	75,197	61,108	150,327	124,496
Time-charter hire expense	18,182	23,424	38,452	48,462
Depreciation and amortization	46,163	47,924	91,733	92,932
General and administrative *(note 9b, 9c, 9d, 10)*	18,157	16,347	36,887	32,981
Loss on sale of vessel			171	
Write-down of vessel *(note 4a, 15)*	8,194		9,094	
Restructuring charge *(note 7)*			3,924	119
Total operating expenses	198,465	183,752	388,625	368,893
Income from vessel operations	35,680	43,086	79,291	91,524
OTHER ITEMS				
Interest expense *(note 6, 9b, 9c, 9d)*	(8,890)	(9,326)	(17,359)	(19,206)
Interest income	150	238	279	403
Realized and unrealized loss on non-designated derivative instruments *(note 10)*	(38,720)	(57,863)	(27,880)	(82,338)
Foreign currency exchange gain (loss) *(note 10)*	367	2,249	(432)	3,871
Other income net *(note 8)*	1,159	1,409	2,469	3,890
Total other items	(45,934)	(63,293)	(42,923)	(93,380)
Income (loss) before income tax (expense) recovery	(10,254)	(20,207)	36,368	(1,856)
Income tax (expense) recovery *(note 11)*	(3,037)	10,453	(5,690)	17,364
Net (loss) income	(13,291)	(9,754)	30,678	15,508
Non-controlling interest in net (loss) income	(1,937)	(7,572)	18,656	3,277
Dropdown Predecessor s interest in net (loss) income *(note 2)*		653		186
General Partner s interest in net (loss) income	1,331	664	3,338	1,683
Limited partners interest: *(note 13)*				
Net (loss) income	(12,685)	(3,499)	8,684	10,362

Net (loss) income per common unit (basic and diluted)	(0.20)	(0.08)	0.14	0.26
Weighted-average number of units outstanding:				
- Common units (basic and diluted) *(note 13)*	62,800,314	42,760,000	60,000,819	40,495,580
Cash distributions declared per unit	0.50	0.48	1.00	0.93

Related party transactions *(note 9)*
The accompanying notes are an integral part of the unaudited consolidated financial statements.

Table of Contents

TEEKAY OFFSHORE PARTNERS L.P. AND SUBSIDIARIES (Note 1)
UNAUDITED CONSOLIDATED BALANCE SHEETS
(in thousands of U.S. dollars)

	As at June 30, 2011 $	As at December 31, 2010 $
ASSETS		
Current		
Cash and cash equivalents	158,644	166,483
Accounts receivable	71,211	64,993
Vessels held for sale *(note 4a)*	8,300	
Net investments in direct financing leases current	19,588	21,157
Prepaid expenses	33,391	29,740
Due from affiliates *(note 9e)*	24,655	19,135
Current portion of derivative instruments *(note 10)*	13,189	6,180
Other current assets	1,284	1,288
Total current assets	330,262	308,976
Vessels and equipment *(note 6)*		
At cost, less accumulated depreciation of $1,252,536 (December 31, 2010 - $1,200,325)	2,302,656	2,247,323
Advances on newbuilding contracts	44,600	52,184
Net investments in direct financing leases	41,134	50,413
Derivative instruments *(note 10)*	12,723	5,202
Other assets	17,611	22,652
Intangible assets net	25,203	28,763
Goodwill shuttle tanker segment	127,113	127,113
Total assets	2,901,302	2,842,626
LIABILITIES AND EQUITY		
Current		
Accounts payable	10,450	12,749
Accrued liabilities *(note 10)*	79,671	88,538
Due to affiliates *(note 9e)*	120,990	67,390
Current portion of long-term debt *(note 6)*	202,677	152,096
Current portion of derivative instruments *(note 10)*	48,303	45,793
Due to joint venture partners	14,500	
Total current liabilities	476,591	366,566
Long-term debt *(note 6)*	1,714,458	1,565,044
Deferred income tax	3,136	1,605

Derivative instruments *(note 10)*	122,746	119,491
Other long-term liabilities	18,836	19,746
Total liabilities	2,335,767	2,072,452
Commitments and contingencies *(note 6, 10, 12)*		
Redeemable non-controlling interest *(note 12a)*	39,604	41,725
Equity		
Non-controlling interest	46,703	170,876
Partners equity	476,265	556,828
Accumulated other comprehensive income	2,963	745
Total equity	525,931	728,449
Total liabilities and total equity	2,901,302	2,842,626

Consolidation of variable interest entities *(note 12c)*
The accompanying notes are an integral part of the unaudited consolidated financial statements.

Table of Contents

TEEKAY OFFSHORE PARTNERS L.P. AND SUBSIDIARIES (Note 1)
UNAUDITED CONSOLIDATED STATEMENT OF CASH FLOWS
(in thousands of U.S. dollars)

	Six Months Ended June 30, 2011 $	2010 $
Cash and cash equivalents provided by (used for)		
OPERATING ACTIVITIES		
Net income	30,678	15,508
Non-cash items:		
Unrealized (gain) loss on derivative instruments *(note 10)*	(7,264)	60,875
Depreciation and amortization	91,733	92,932
Loss on sale and write down of vessels and equipment	9,265	
Deferred income tax expense (recovery) *(note 11)*	3,849	(21,080)
Foreign currency exchange loss and other	10,250	1,166
Change in non-cash working capital items related to operating activities	25,655	9,026
Expenditures for drydocking	(11,660)	(11,410)
Net operating cash flow	152,506	147,017
FINANCING ACTIVITIES		
Proceeds from drawdown of long-term debt	311,472	81,600
Scheduled repayments of long-term debt *(note 6)*	(69,429)	(50,398)
Prepayments of long-term debt	(50,360)	(150,048)
Advance from joint venture partner	14,500	
Repayment of long-term debt relating to Dropdown Predecessor relating to *Falcon Spirit (note 9b)*		(32,834)
Contribution by Teekay Corporation relating to acquisition of *Rio das Ostras (note 9c)*	2,000	
Distribution to Teekay Corporation for the acquisition of *Falcon Spirit (note 9b)*		(11,295)
Equity contribution from Teekay Corporation		5,020
Purchase of 49% interest in Teekay Offshore Operating L.P. *(note 9a)*	(160,000)	
Equity contribution from Teekay Corporation to Dropdown Predecessor relating to *Falcon Spirit (note 9b)*		805
Equity contribution from joint venture partner	2,250	333
Proceeds from issuance of common units		100,581
Expenses of equity offerings	(91)	(5,043)
Cash distributions paid by the Partnership	(61,335)	(39,126)
Cash distributions paid by subsidiaries to non-controlling interests	(19,642)	(42,968)
Other		(523)
Net financing cash flow	(30,635)	(143,896)

INVESTING ACTIVITIES		
Expenditures for vessels and equipment	(145,611)	(4,813)
Proceeds from sale of vessels and equipment	5,054	
Investment in direct financing lease assets	370	(886)
Direct financing lease payments received	10,477	11,607
Net investing cash flow	(129,710)	5,908
(Decrease) increase in cash and cash equivalents	(7,839)	9,029
Cash and cash equivalents, beginning of the period	166,483	109,407
Cash and cash equivalents, end of the period	158,644	118,436

Supplemental cash flow disclosure *(note 14)*

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

Table of Contents

TEEKAY OFFSHORE PARTNERS L.P. AND SUBSIDIARIES (Note 1)
UNAUDITED CONSOLIDATED STATEMENT OF CHANGES IN TOTAL EQUITY
(in thousands of U.S. dollars and units)

	PARTNERS EQUITY						
	Limited Partner		General Partner	Other Comprehensive Income (Loss) (Note 10)	Non-controlling Interest	Total Equity	Redeemable Non-controlling Interest
	Common Units	$	$	$	$	$	$
Balance as at December 31, 2010	55,238	540,355	16,473	745	170,876	728,449	41,725
Net income		8,684	3,338		18,656	30,678	
Reclassification of redeemable non-controlling interest in net income					(2,521)	(2,521)	2,521
Unrealized net gain on qualifying cash flow hedging instruments *(note 10)*				2,282	730	3,012	
Realized net gain on qualifying cash flow hedging instruments *(note 10)*				(1,226)	(285)	(1,511)	
Cash distributions		(57,638)	(3,697)		(15,000)	(76,335)	(4,642)
Contribution of capital from joint venture partner					2,250	2,250	
Contribution of capital from Teekay Corporation to *Rio das Ostras (note 9c)*		1,960	40			2,000	
Equity offering *(note 9a, 13)*	7,563	221,742	4,525			226,267	
Purchase of 49% of Teekay Offshore Operating L.P. *(note 9a)*		(254,237)	(5,189)	1,162	(128,003)	(386,267)	
Other		(91)				(91)	
Balance as at June 30, 2011	62,801	460,775	15,490	2,963	46,703	525,931	39,604

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

Table of Contents

TEEKAY OFFSHORE PARTNERS L.P. AND SUBSIDIARIES (Note 1)
UNAUDITED CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME
(in thousands of U.S. dollars)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
	$	$	$	$
Net (loss) income	(13,291)	(9,754)	30,678	15,508
Other comprehensive income (loss):				
Unrealized net gain (loss) on qualifying cash flow hedging instruments *(note 10)*	1,029	(8,369)	3,012	(10,724)
Realized net (gain) loss on qualifying cash flow hedging instruments *(note 10)*	(746)	758	(1,511)	1,471
Pension adjustment		(302)		(586)
Other comprehensive income (loss)	283	(7,913)	1,501	(9,839)
Comprehensive (loss) income	(13,008)	(17,667)	32,179	5,669
Non-controlling interest in comprehensive (loss) income	(1,937)	(10,993)	19,101	(879)
Dropdown Predecessor s interest in comprehensive (loss) income *(note 2)*		(274)		(1,169)
Partners interest in comprehensive (loss) income	(11,071)	(6,400)	13,078	7,717

TEEKAY OFFSHORE PARTNERS L.P. AND SUBSIDIARIES
NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
(all tabular amounts stated in thousands of U.S. dollars, except unit and per unit data)

1. Basis of Presentation

The unaudited interim consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles (or *GAAP*). These financial statements include the accounts of Teekay Offshore Partners L.P., which is a limited partnership organized under the laws of the Republic of The Marshall Islands, its wholly owned or controlled subsidiaries and the Dropdown Predecessor, as described in Note 2 below and variable interest entities (or *VIEs*) for which Teekay Offshore Partners L.P. or its subsidiaries are the primary beneficiaries (see Note 12) (collectively, the *Partnership*). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Certain information and footnote disclosures required by GAAP for complete annual financial statements have been omitted; therefore, these interim financial statements should be read in conjunction with the Partnership s audited consolidated financial statements for the year ended December 31, 2010, which are included in the Partnership s Annual Report on Form 20-F. In the opinion of management of our general partner, Teekay Offshore GP L.L.C. (or the *General Partner*), these interim unaudited consolidated financial statements reflect all adjustments, of a normal recurring nature, necessary to present fairly, in all material respects, the Partnership s consolidated financial position, results of operations, changes in total equity and cash flows for the interim periods presented. The results of operations for the interim periods presented are not necessarily indicative of those for a full fiscal year. Historically, the utilization of shuttle tankers in the North Sea is higher in the winter months and lower in the summer months, as generally there is higher maintenance in the oil fields during the summer months, which leads to lower oil production, and thus, lower shuttle tanker utilization during that period. Significant intercompany balances and transactions have been eliminated upon consolidation.

2. Dropdown Predecessor

On April 1, 2010, the Partnership acquired from Teekay Corporation a floating storage and offtake (or *FSO*) unit, the *Falcon Spirit*, together with its time-charter-out contract. This transaction was accounted for as a business acquisition between entities under common control. As a result, the Partnership s consolidated statements of income, cash flows and comprehensive income for the six months ended June 30, 2010 include the results of the acquired vessel (referred to herein, together with the results of the *Cidade de Rio das Ostras* (or *Rio das Ostras*), described below, as the *Dropdown Predecessor*), from the date that the Partnership and the acquired vessel were both under common control of Teekay Corporation and had begun operations. The vessel began operations under the ownership of Teekay Corporation on December 15, 2009. The effect of adjusting the Partnership s financial statements to account for the common control transfer of the *Falcon Spirit* increased the Partnership s net income and comprehensive income by $0.9 million for the six months ended June 30, 2010.

On October 1, 2010, the Partnership acquired from Teekay Corporation a floating production, storage and offloading (or *FPSO*) unit, the *Rio das Ostras*. This transaction was accounted for as a business acquisition between entities under common control. As a result, the Partnership s consolidated statements of (loss) income and comprehensive (loss) income for the three and six months ended June 30, 2010 and the Partnership s statement of cash flow for the six months ended June 30, 2010 have been retroactively adjusted to include the results of the *Rio das Ostras* FPSO unit from the date that the Partnership and the acquired vessel were both under common control of Teekay Corporation and had begun operations. Teekay Corporation had an 82% interest in the *Rio das Ostras* FPSO unit when it commenced operations on April 1, 2008. Teekay Corporation acquired the remaining 18% interest on June 30, 2008. Adjusting the Partnership s financial statements to account for the common control transfer of the *Rio das Ostras* FPSO unit decreased the Partnership s net loss and increased the Partnership s comprehensive loss by $0.7 million and $0.3 million, respectively, for the three months ended June 30, 2010 and decreased the Partnership s net income and comprehensive income by

$0.7 million and $2.1 million, respectively, for the six months ended June 30, 2010.

3. Adoption of New Accounting Policies

In January 2011, the Partnership adopted an amendment to Financial Accounting Standards Board (or *FASB*) Accounting Standards Codification (or *ASC*) 605, *Revenue Recognition,* that provides for a new methodology for establishing the fair value for a deliverable in a multiple-element arrangement. When a vendor specific objective or third-party evidence for deliverables in a multiple-element arrangement cannot be determined, the Partnership will be required to develop a best estimate of the selling price of separate deliverables and to allocate the arrangement consideration using the relative selling price method. The adoption of this standard did not have an impact on the Partnership s consolidated financial statements.

4. Financial Instruments

a) Fair Value Measurements

For a description on how the Partnership estimates fair value, see Note 2 in the Partnership s audited consolidated financial statements filed with its Annual Report on Form 20-F for the year ended December 31, 2010. The estimated fair value of the Partnership s financial instruments and categorization using the fair value hierarchy for these financial instruments that are measured at fair value on a recurring basis are as follows:

TEEKAY OFFSHORE PARTNERS L.P. AND SUBSIDIARIES
NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
(all tabular amounts stated in thousands of U.S. dollars, except unit and per unit data)

	Fair Value Hierarchy Level (1)	June 30, 2011 Carrying Amount Asset (Liability) $	June 30, 2011 Fair Value Asset (Liability) $	December 31, 2010 Carrying Amount Asset (Liability) $	December 31, 2010 Fair Value Asset (Liability) $
Cash and cash equivalents		158,644	158,644	166,483	166,483
Due from affiliates *(note 9e)*		24,655	24,655	19,135	19,135
Due to affiliates *(note 9e)*		(120,990)	(120,990)	(67,390)	(67,390)
Long-term debt *(note 6)*		(1,917,135)	(1,825,649)	(1,717,140)	(1,620,355)
Due to joint venture partner (2)		(14,500)	(14,500)		
Derivative instruments *(note 10)*					
Interest rate swap agreements	Level 2	(181,711)	(181,711)	(175,784)	(175,784)
Cross currency swap agreement	Level 2	13,668	13,668	4,233	4,233
Foreign currency forward contracts	Level 2	12,516	12,516	6,909	6,909

(1) The fair value hierarchy level is only applicable to each financial instrument on the consolidated balance sheets that is recorded at fair value on a recurring basis.

(2) The fair value of the Partnership s advances from its joint venture partner approximates its carrying amount due to the current nature of the balance.

The Partnership has determined that there were no non-financial assets or non-financial liabilities carried at fair value at June 30, 2011 and December 31, 2010, except for a 1992-built shuttle tanker, which was written down to an estimated fair value of $11.0 million at December 31, 2010 and a 1993-built conventional tanker, which was written down to an estimated fair value of $8.3 million at June 30, 2011. The fair value of the vessels were determined based on directly observable inputs (level 2).

b) Financing Receivables

The following table contains a summary of the Partnership s financing receivables by type of borrower and the method by which the Partnership monitors the credit quality of its financing receivables on a quarterly basis:

	Credit Quality Indicator	Grade	June 30, 2011 $	December 31, 2010 $
Direct financing leases	Payment activity	Performing	60,722	71,570

5. Segment Reporting

The following tables include results for the Partnership s segments for the periods presented in these consolidated financial statements:

Shuttle **Conventional**

	Tanker Segment		Tanker Segment		FSO Segment		FPSO Segment		Total	
	Three Months Ended June 30,									
	2011 $	2010 $	2011 $	2010 $	2011 $	2010 $	2011 $	2010 $	2011 $	2010 $
Revenues	139,183	144,295	37,454	26,431	14,947	18,419	42,561	37,693	234,145	226,838
Voyage expenses	25,712	30,031	6,539	4,842	321	76			32,572	34,949
Vessel operating expenses	42,109	32,346	6,012	5,657	7,411	8,420	19,665	14,685	75,197	61,108
Time-charter hire expense	18,182	23,424							18,182	23,424
Depreciation and amortization	28,704	29,280	5,557	5,921	2,991	3,829	8,911	8,894	46,163	47,924
General and administrative (1)	13,197	11,603	758	1,139	1,242	1,009	2,960	2,596	18,157	16,347
Write-down of vessel			8,194						8,194	
Income from vessel operations	11,279	17,611	10,394	8,872	2,982	5,085	11,025	11,518	35,680	43,086

Table of Contents

TEEKAY OFFSHORE PARTNERS L.P. AND SUBSIDIARIES
NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
(all tabular amounts stated in thousands of U.S. dollars, except unit and per unit data)

	Shuttle Tanker Segment		Conventional Tanker Segment		FSO Segment		FPSO Segment		Total	
	Six Months Ended June 30,									
	2011	2010	2011	2010	2011	2010	2011	2010	2011	2010
	$	$	$	$	$	$	$	$	$	$
Revenues	277,415	286,288	73,217	57,996	32,438	39,069	84,846	77,064	467,916	460,417
Voyage expenses	44,740	59,085	12,685	10,493	612	325			58,037	69,903
Vessel operating expenses	82,894	66,509	11,837	11,371	16,559	16,825	39,037	29,791	150,327	124,496
Time-charter hire expense	38,452	48,462							38,452	48,462
Depreciation and amortization	56,136	54,235	11,602	11,663	6,172	9,246	17,823	17,788	91,733	92,932
General and administrative (1)	25,679	22,863	2,507	2,332	2,305	2,019	6,396	5,767	36,887	32,981
Loss on sale of vessel					171				171	
Write-down of vessel			9,094						9,094	
Restructuring charge	1,227	119			2,697				3,924	119
Income from vessel operations	28,287	35,015	25,492	22,137	3,922	10,654	21,590	23,718	79,291	91,524

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

A reconciliation of total segment assets to total assets presented in the accompanying consolidated balance sheets is as follows:

	June 30, 2011	December 31, 2010
	$	$
Shuttle tanker segment	1,792,134	1,711,341
Conventional tanker segment	286,539	304,655

FSO segment	104,533	119,844
FPSO segment	520,045	513,886
Unallocated:		
Cash and cash equivalents	158,644	166,483
Other assets	39,407	26,417
Consolidated total assets	2,901,302	2,842,626

6. Long-Term Debt

	June 30, 2011 $	December 31, 2010 $
U.S. Dollar-denominated Revolving Credit Facilities due through 2018	1,237,132	1,066,909
Norwegian Kroner Bond due in 2013	111,373	103,061
U.S. Dollar-denominated Term Loans due through 2017	204,459	244,958
U.S. Dollar-denominated Term Loans due through 2023	364,171	302,212
Total	1,917,135	1,717,140
Less current portion	202,677	152,096
Long-term portion	1,714,458	1,565,044

As at June 30, 2011, the Partnership had nine long-term revolving credit facilities, which, as at such date, provided for borrowings of up to $1,372.4 million, of which $135.4 million was undrawn. The total amount available under the revolving credit facilities reduces by $89.6 million (remainder of 2011), $187.0 million (2012), $333.5 million (2013), $659.4 million (2014), $17.5 million (2015) and $85.4 million (thereafter). Six of the revolving credit facilities are guaranteed by the Partnership and certain of its subsidiaries for all outstanding amounts and contain covenants that require the Partnership 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 the Partnership s total consolidated debt. The Partnership also has a revolving credit facility of which Teekay Corporation guarantees $65.0 million of the final repayment. In addition to the Partnership covenants described above, Teekay Corporation is also required 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 $50.0 million and 5.0% of Teekay Corporation s total consolidated debt which has recourse to Teekay Corporation. 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 (cash and cash equivalents) 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 35 of the Partnership s vessels, together with other related security.

TEEKAY OFFSHORE PARTNERS L.P. AND SUBSIDIARIES
NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
(all tabular amounts stated in thousands of U.S. dollars, except unit and per unit data)

On November 30, 2010, the Partnership issued NOK 600 million ($111.4 million) of senior unsecured bonds that mature in November 2013 in the Norwegian bond market. The Partnership capitalized issuance costs of $1.3 million, which is recorded in other non-current assets in the consolidated balance sheet, and is amortized over the term of the senior unsecured bonds. The bonds are listed on the Oslo Stock Exchange. Interest payments on the bonds are based on NIBOR plus a margin of 4.75%. The Partnership entered into a cross currency swap and an interest rate swap to swap the interest payments from NIBOR to a fixed rate of 1.12% and principal from Norwegian Kroner to US dollars. The LIBOR rate receivable from the interest rate swap is capped at 3.5% (see Note 10).

As at June 30, 2011, five of the Partnership s 50% owned subsidiaries each had an outstanding term loan, which in the aggregate totaled $204.5 million. The term loans reduce over time with quarterly and semi-annual payments and have varying maturities through 2017. These term loans are collateralized by first-priority mortgages on the five vessels to which the loans relate, together with other related security. As at June 30, 2011, the Partnership had guaranteed $57.3 million of these term loans, which represents its 50% share of the outstanding vessel mortgage debt of four of these 50% owned subsidiaries. The other owner and Teekay Corporation have guaranteed $102.2 million and $44.9 million, respectively.

As at June 30, 2011, the Partnership had term loans outstanding for the shuttle tankers the *Amundsen Spirit*, the *Nansen Spirit*, the *Peary Spirit*, and the *Rio das Ostras* FPSO unit which in aggregate totaled $364.2 million. The Partnership has consolidated the *Peary Spirit* LLC as a variable interest entity in its consolidated financial statements since October 1, 2010 (see Note 12(c)). For the term loans for the *Amundsen Spirit* and the *Nansen Spirit*, one tranche reduces in semi-annual payments while the other tranche correspondingly is drawn up every six months with a final $29.1 million bullet payment due 2022 and 2023, respectively. The term loans for the *Peary Spirit* and the *Rio das Ostras* reduce over time with quarterly and semi-annual payments. These four term loans have varying maturities through 2023 and are collateralized by first-priority mortgages on the vessels to which the loans relate, together with other related security and are guaranteed by Teekay Corporation.

Interest payments on the revolving credit facilities and the term loans are based on LIBOR plus a margin. At June 30, 2011, the margins ranged between 0.30% and 3.25%. The weighted-average effective interest rate on the Partnership s variable rate long-term debt as at June 30, 2011 was 1.5%. This rate does not include the effect of the Partnership s interest rate swaps (see Note 10).

The aggregate annual long-term debt principal repayments required to be made subsequent to June 30, 2011 are $100.0 million (remainder of 2011), $207.5 million (2012), $419.4 million (2013), $805.1 million (2014), $59.7 million (2015), and $325.4 million (thereafter).

As at June 30, 2011, the Partnership and Teekay Corporation were in compliance with all covenants related to the credit facilities and long-term debt.

7. Restructuring Charge

During the three months ended March 31, 2011, the Partnership sold the FSO unit, *Karratha Spirit*, and the time-charter-out contract for the *Basker Spirit* was terminated. The Partnership committed to plans for termination of the employment of certain seafarers of the two vessels. Under the plans, the Partnership recorded restructuring charges of $3.9 million in the six months ended June 30, 2011.

8. Other Income Net

	Three Months Ended June 30, 2011 $	Three Months Ended June 30, 2010 $	Six Months Ended June 30, 2011 $	Six Months Ended June 30, 2010 $
Volatile organic compound emissions plant lease income	821	1,210	1,782	2,720
Miscellaneous	338	199	687	1,170
Other income net	1,159	1,409	2,469	3,890

9. Related Party Transactions and Balances

a) On March 8, 2011, the Partnership acquired Teekay Corporation s 49% interest in Teekay Offshore Operating L.P. (or *OPCO*) for a combination of $175 million in cash (less $15 million in distributions made by OPCO to Teekay Corporation between December 31, 2010 and the date of acquisition) and the issuance of 7.6 million of the Partnership s common units to Teekay Corporation and a 2% proportionate interest to the General Partner in a private placement (see Note 13). The acquisition increased the Partnership s ownership of OPCO to 100%. The excess of the proceeds paid by the Partnership over Teekay Corporation s historical book value of $128.0 million for the 49% interest in OPCO was accounted for as an equity distribution to Teekay Corporation of $258.3 million.

b) On April 1, 2010, the Partnership acquired Teekay Corporation s 100% interest in a FSO unit, the *Falcon Spirit,* together with its time-charter-out contract, for a purchase price of $44.1 million. The purchase was partially financed through proceeds from a public offering of common units. The *Falcon Spirit* is chartered to a subsidiary of Occidental Petroleum of Qatar Ltd., on a fixed-rate time-charter-out contract for 7.5 years (beginning December 2009) with an option for the charterer to extend the contract for an additional 1.5 years. The acquisition consisted of the Partnership acquiring Teekay Corporation s equity interest in Teekay Al Raayan LLC for $11.3 million and Teekay Corporation s interest in amounts due to Teekay Corporation from Teekay Al Raayan LLC for $32.8 million.

Table of Contents

TEEKAY OFFSHORE PARTNERS L.P. AND SUBSIDIARIES
NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
(all tabular amounts stated in thousands of U.S. dollars, except unit and per unit data)

For the six months ended June 30, 2010, $0.3 million of general and administrative expenses (consisting primarily of vessel management fees and legal and professional fees) and $0.4 million of interest expense from credit facilities that were used to finance the acquisition of the *Falcon Spirit* were incurred by Teekay Corporation and have been allocated to the Partnership as part of the results of the Dropdown Predecessor.

c) On October 1, 2010, the Partnership acquired from Teekay Corporation the *Rio das Ostras* FPSO unit, which is on a long-term charter to Petroleo Brasileiro SA (or *Petrobras*), for a purchase price of $157.7 million, plus working capital of $12.4 million. The purchase agreement provides that Teekay Corporation shall reimburse the Partnership for upgrade costs in excess of the upgrade estimate as of the closing date. During the three and six months ended June 30, 2011, Teekay Corporation reimbursed the Partnership for $1.0 million and $2.0 million, respectively, of such upgrade costs, which is reflected as a capital contribution.

For the three and six months ended June 30, 2010, the following costs attributable to the operations of the *Rio das Ostras* were incurred by Teekay Corporation, and have been allocated to the Partnership as part of the results of the Dropdown Predecessor:

General and administrative expenses (consisting primarily of salaries, defined benefit pension plan benefits, and other employee related costs, office rent, legal and professional fees, and travel and entertainment) of $1.5 million and $3.3 million, respectively.

Interest expense from credit facilities that were used to finance the acquisition of the *Rio das Ostras* of $0.8 million and $1.3 million, respectively.

Loss from changes in the foreign exchange rate on the foreign exchange forward contracts of ($0.6) million and ($0.8) million, respectively, is reflected in other comprehensive (loss) income.

d) During the three and six months ended June 30, 2011, nine conventional tankers, two shuttle tankers and two FSO units of the Partnership were employed on long-term time-charter-out contracts with subsidiaries of Teekay Corporation, and two conventional tankers of the Partnership were employed on long-term time-charter-out contracts with a joint venture in which Teekay Corporation has a 50% interest. In addition, during the three and six months ended June 30, 2011, two shuttle tankers of the Partnership were employed on short-term contracts with subsidiaries of Teekay Corporation. Teekay Corporation and its wholly owned subsidiaries provide substantially all of the Partnership s commercial, technical, crew training, strategic and administrative services needs. In addition, the Partnership reimburses the General Partner for expenses incurred by the General Partner that are necessary or appropriate for the conduct of the Partnership s business. Revenues (expenses) from such related party transactions were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
	$	$	$	$
Revenues(1)	45,813	32,536	88,101	70,316
Vessel operating expenses(2)	(1,626)	(1,171)	(2,882)	(2,237)
General and administrative(3)(4)(5)	(15,456)	(11,994)	(30,144)	(24,256)
Interest expense(6)		(808)		(3,048)

(1) Revenue from long-term time-charter-out contracts and short-term time-charter-out contracts with subsidiaries or affiliates of Teekay Corporation.

(2) Crew training fees charged from Teekay Corporation.

(3) Commercial, technical, strategic and administrative management fees charged by Teekay Corporation.

(4) Amounts include $0.3 million and $0.5 million, respectively, during the three and six months ended June 30, 2011, and $0.1 million and $0.3 million, respectively, during the three and six months ended June 30, 2010 of reimbursements of costs incurred by the General Partner.

(5) Amounts are net of $1.1 million and $2.1 million, respectively, during the three and six months ended June 30, 2011, and $0.9 million and $1.8 million, respectively, during the three and six months ended June 30, 2010 of management fees from ship management services provided by the Partnership to a subsidiary of Teekay Corporation.

(6) Interest paid to Teekay Corporation for financing the Partnership s acquisition of a FPSO unit and interest allocated from Teekay Corporation as a result of the Dropdown Predecessor.

e) At June 30, 2011, due from affiliates totaled $24.7 million (December 31, 2010 $19.1 million) and due to affiliates totaled $121.0 million (December 31, 2010 $67.4 million). Due to and from affiliates are non-interest bearing and unsecured obligations, and are expected to be settled within the next fiscal year in the normal course of operations.

10. Derivative Instruments and Hedging Activities

The Partnership uses derivatives to manage certain risks in accordance with its overall risk management policies.

Foreign Exchange Risk

The Partnership economically hedges portions of its forecasted expenditures denominated in foreign currencies with foreign currency forward contracts. Certain foreign currency forward contracts are designated, for accounting purposes, as cash flow hedges of forecasted foreign currency expenditures.

**TEEKAY OFFSHORE PARTNERS L.P. AND SUBSIDIARIES
NOTES TO THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
(all tabular amounts stated in thousands of U.S. dollars, except unit and per unit data)**

As at June 30, 2011, the Partnership was committed to the following foreign currency forward contracts:

	Contract Amount in Foreign Currency (thousands)	Fair Value / Carrying Amount of Asset/(Liability) (in thousands of U.S. Dollars)		Average Forward Rate[1]	Expected Maturity	
		Hedge	Non-hedge		2011 (in thousands of U.S. Dollars)	2012
Norwegian Kroner	418,000	3,711	7,272	6.39	27,925	37,585
British Pound	2,940		243	0.66	2,548	1,919
Euro	10,700		1,290	0.76	7,972	6,176
		3,711	8,805		38,445	45,680

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

The Partnership incurs interest expense on its Norwegian Kroner-denominated bonds. The Partnership entered into a cross currency swap to economically hedge the foreign exchange risk on the principal and interest. As at June 30, 2011, the Partnership was committed to one cross currency swap with the notional amounts of NOK 600 million and $98.5 million, which exchanges a receipt of floating interest based on NIBOR plus a margin of 4.75% with a payment of floating interest based on LIBOR plus a margin of 5.04%. In addition, the cross currency swap locks in the transfer of principal to $98.5 million upon maturity in exchange for NOK 600 million. The positive fair value of the cross currency swap as at June 30, 2011 was $13.7 million. The Partnership has not designated, for accounting purposes, the cross currency swap as a hedge.

Interest Rate Risk

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 U.S. Dollar LIBOR-denominated borrowings.

As at June 30, 2011, the Partnership was committed to the following interest rate swap agreements:

	Interest Rate Index	Principal Amount $	Fair Value / Carrying Amount of Assets (Liability) $	Weighted-Average Remaining Term (years)	Fixed Interest Rate (%)[1]
U.S. Dollar-denominated interest rate swaps [2]	LIBOR	800,000	(119,388)	12.1	4.6
	LIBOR	669,000	(61,568)	6.0	4.0

U.S. Dollar-denominated interest rate swaps (3)					
U.S. Dollar-denominated interest rate swap (2)(4)	LIBOR	98,500	(755)	2.4	1.1
		1,567,500	(181,711)		

(1) Excludes the margin the Partnership pays on its variable-rate debt, which as at June 30, 2011, ranged between 0.30% and 3.25%.

(2) Notional amount remains constant over the term of the swap.

(3) Principal amount reduces quarterly or semi-annually.

(4) The LIBOR rate receivable is capped at 3.5%.

Tabular disclosure

The following table presents the location and fair value amounts of derivative instruments, segregated by type of contract, on the Partnership s balance sheets.

	Current portion of derivative assets	Derivative assets	Accrued liabilities	Current portion of derivative liabilities	Derivative liabilities
As at June 30, 2011					
Foreign currency contracts cash flow hedges	3,119	592			
Foreign currency contracts not designated as hedges	6,997	1,808			