

OVERSEAS SHIPHOLDING GROUP INC  
Form 10-K  
March 01, 2007

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**SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**FORM 10-K**

FOR ANNUAL AND TRANSITION REPORTS  
PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

(Mark One)

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

For the fiscal year ended December 31, 2006

OR

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

For the Transition Period from \_\_\_\_\_ to \_\_\_\_\_  
Commission File Number 1-6479-1

**OVERSEAS SHIPHOLDING GROUP, INC.**

(Exact name of registrant as specified in its charter)

Delaware	13-2637623
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
666 Third Avenue, New York, New York	10017
(Address of principal executive offices)	(Zip Code)
Registrant's telephone number, including area code: 212-953-4100 Securities registered pursuant to Section 12(b) of the Act:	
Title of each class	Name of each exchange on which registered
Common Stock (par value \$1.00 per share)	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: **NONE**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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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.

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

The aggregate market value of the Common Stock held by non-affiliates of the registrant on June 30, 2006, the last business day of the registrant's most recently completed second quarter, was \$2,117,808,906, based on the closing price of \$59.15 per share on the New York Stock Exchange on that date. (For this purpose, all outstanding shares of Common Stock have been considered held by non-affiliates, other than the shares beneficially owned by directors, officers and certain 5% shareholders of the registrant; certain of such persons disclaim that they are affiliates of the registrant.)

As of February 26, 2007, 39,359,177 shares of Common Stock were outstanding.

### **DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant's definitive proxy statement to be filed by the registrant in connection with its 2007 Annual Meeting of Shareholders are incorporated by reference in Part III.

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## PART I

### ITEM 1. BUSINESS

#### OVERVIEW

Overseas Shipholding Group, Inc. ("OSG" or the "Company") is one of the world's leading bulk shipping companies engaged primarily in the ocean transportation of crude oil and petroleum products. At December 31, 2006, the Company owned or operated a modern fleet of 103 vessels (aggregating 11.7 million deadweight tons) of which 80 vessels operated in the international market and 23 operated in the U.S. Flag market. OSG's newbuilding program of owned and chartered-in vessels totaled 34 and extends across each of its operating segments, bringing the Company's total operating and newbuild fleet to 137 vessels.

OSG's vessel operations are organized into strategic business units and focused on market segments each serve: crude oil, refined petroleum products, U.S. Flag vessels and gas. The International Crude Tanker unit manages International Flag V-Plus, VLCC, Aframax and Panamax tankers; the International Product Carriers unit principally manages long- and medium-range Product Carriers; the U.S. unit manages most U.S. Flag vessels; and the Gas unit is developing its chartering and commercial capabilities in preparation for the delivery of four LNG carriers beginning in late 2007. Each business unit has dedicated chartering and commercial personnel while the Company's technical ship management operations and corporate departments support the Company's global fleet and corporate operations.

The Company generally charters its vessels either for specific voyages at spot rates or for specific periods of time at fixed monthly amounts. Spot market rates are highly volatile, while time charter rates are fixed for a specific period of time, and provide a more predictive stream of Time Charter Equivalent Revenues. For a more detailed discussion on factors influencing spot and time charter markets, see Operations Charter Types later in this section.

A glossary of shipping terms (the "Glossary") that should be used as a reference when reading this Annual Report on Form 10-K can be found later in Item 1. Capitalized terms that are used in this Annual Report are either defined when they are first used or in the Glossary.

#### BUSINESS STRATEGY

The Company's vision is to be a market leader in each of the segments in which it operates. To support its goal of market leadership, OSG balances the expansion of its International and U.S. Flag fleets on an opportunistic basis, continuously improves its operations and seeks to maintain a strong balance sheet and financial flexibility to support future growth. OSG believes that it differentiates itself from its competitors through the scale and diversity of its fleet, the skills, experience and capabilities of its sea-based crew and shore-based personnel, and its reputation of providing reliable, safe transportation services to customers while protecting the health and safety of its crews and the sanctity of the environment.

*Balanced Growth* The Company believes that by balancing the types of vessels it deploys and actively managing the mix of charter types as well as the ownership profile of its fleet, it can maximize returns on invested capital while making it less dependent on any particular market sector.

*Operational Excellence* The Company is committed to technical excellence across its fleet. The Company's high quality, modern fleet, which is operated by experienced crews, is supported by a program of standardized operational practices and procedures that are designed to ensure that seafarers and vessel operations comply with all applicable environmental, regulatory and safety standards established by International and U.S. maritime laws. The Company has a philosophy of continuous improvement in its systems and technologies designed to support such compliance. For more information, see Technical Operations later in this section.

*Financial Flexibility* The Company believes its strong balance sheet, high credit rating and high level of unencumbered assets give it access to both the unsecured bank markets and to the public debt markets, allowing it to borrow primarily on an unsecured basis. This, in turn, reduces its financing costs and cash flow breakeven levels. This financial flexibility permits the Company to pursue attractive business opportunities.

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### Summary of 2006 Events

During 2006, the Company pursued numerous initiatives that supported its balanced growth strategy, some of which are highlighted below.

#### *Fleet Diversification and Expansion*

*Acquisition of Maritrans* On November 28, 2006, the Company completed the acquisition of Maritrans Inc., a leading U.S. Flag crude oil and petroleum product shipping company with a fleet of 19 operating and newbuild vessels. OSG paid \$37.50 per share, which valued the transaction at approximately \$506 million, including debt assumed upon closing. OSG has initially financed the acquisition through borrowings under existing credit facilities. As a result of the combination, OSG's U.S. Flag fleet now totals 37 operating and newbuild vessels that include Handysize Product Carriers, Articulated Tug Barges ("ATBs"), Dry Bulk Carriers and a Car Carrier. OSG will be able to use approximately \$292 million of its Capital Construction Fund to fund payments towards the construction contracts and related costs of three newbuild ATBs. The strategic acquisition gives OSG a presence in all major U.S. Jones Act trading routes (intra U.S. Gulf, U.S. Gulf to the East Coast, U.S. Gulf to the West Coast, the Alaskan North Slope trades and the Delaware Bay) and provides customers with a broad range of short- and long-haul transportation and lightering services.

*Entrance into the CNG Transportation Market through a Strategic Partnership with TransCanada* On August 6, 2006, OSG announced a strategic partnership with TransCanada CNG Technologies Ltd., a subsidiary of TransCanada Corporation. Under the agreement, OSG will develop and operate a new type of vessel capable of moving large quantities of compressed natural gas ("CNG"). The ships will utilize TransCanada's patented technology for the design, construction and operation of Gas Transport Modules ("GTMs") for the transportation of CNG from stranded gas fields throughout the world.

*Product Carrier Fleet Expansion* Augmenting a fleet expansion program that began in 2005, during 2006 OSG ordered or chartered-in 10 medium-range ("MR") Product Carriers, vessels capable of transporting petroleum products, vegetable oils and easy chemicals.

In the first half of 2006, OSG time chartered-in four 47,000 dwt IMO III Product Carriers, from subsidiaries of Cido Tanker Holding Co., a privately held shipping company. Two of the vessels, the Overseas Aquarius and the Overseas Leo, have been chartered-in for periods of seven years with three year extension options. The Overseas Polaris and the Overseas Pisces have been chartered-in for 10 years. The sister ships will be built by Hyundai Mipo Dockyard Co. Ltd., in Ulsan, South Korea and are scheduled to be delivered to OSG between May 2008 and July 2009.

In the third quarter of 2006, OSG took delivery of two 51,000 dwt IMO III Product Carriers from Hong-Kong based Parakou Shipping Ltd. The Company has control of the vessels, the Overseas Hercules and the Overseas Orion, built by STX Shipbuilding Co., Ltd. in Chinhae, South Korea, for a period of 10 years. Two additional sister ships, the Overseas Cygnus and the Overseas Sextans, also time chartered-in from Parakou, are scheduled for delivery in the first half of 2007. The order for the vessels was announced on October 7, 2005.

On November 2, 2006, the Company announced the bareboat charter-in of three 50,000 dwt IMO II/III Product Carriers from Capital Maritime and Trading, Inc. for 10 years. The Overseas Serifos, the Overseas Sifnos and the Overseas Kimolos will be constructed at the STX Shipbuilding Co., Ltd. in South Korea. The vessels are slated for delivery in 2008.

In the fourth quarter of 2006, OSG bareboat chartered-in one 47,000 dwt IMO III Product Carrier from Daishin Technos Co., Ltd., a privately held shipping company in Japan, for a period of eight years with an option to purchase the vessel beginning in 2015. The vessel, to be named the Overseas Carina, will be built by Imabari Shipbuilding Co., Ltd. in Japan, and is expected to be delivered to OSG in the third quarter of 2010.

In the fourth quarter of 2006, the Company agreed to build two 52,000 dwt IMO III Product Carriers at Hyundai Mipo Dockyard Co. Ltd. The vessels are scheduled to be delivered to OSG in 2010.

*Crude Oil Tanker Fleet* In the first quarter of 2006, OSG announced that it will build four 114,000 dwt 44-meter beam Aframax tankers at the New Times Shipbuilding Co. Ltd. shipyard based in Jinjiang, China. The vessels, scheduled for delivery in 2008 and 2009, will operate in the Aframax International pool and increase OSG's ability to serve customers

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in the Atlantic basin. The tankers will be built using the new Common Structural Rules recently established by the International Association of Classification Societies ("IACS") for all tankers and bulk carriers ordered after April 1, 2006. The new Common Structural Rules include stricter hull strength requirements.

On April 24, 2006, Flota Petrolera Ecuatoriana ("FLOPEC"), an Ecuadorian state-owned oil company, joined Panamax International, bringing the number of vessels in the commercial pool to 20 modern, double hull tankers, all of which trade in the Americas. In addition to adding five vessels to the pool, FLOPEC provides access to preference cargoes coming out of Ecuador.

### *Financial Strength and Stability*

On February 15, 2006, the Company announced it had entered into a \$1.8 billion seven-year unsecured revolving credit agreement with a group of banks. Borrowings under this facility bear interest at a rate based on LIBOR. The terms, conditions and financial covenants were generally more favorable than those contained in the Company's prior long-term facilities. In connection with entering into the agreement, the Company terminated all of its other unsecured revolving credit facilities (long-term credit of \$1.285 billion and short-term of \$45 million).

On April 12, 2006, OSG's Board of Directors announced a regular quarterly dividend of 25¢ per share, a 43% increase from 17.5¢ per share, which had been in place since June 2003. OSG has paid a quarterly dividend to stockholders since 1974.

On June 9, 2006, the Company announced a share repurchase program of \$300 million, which, at the time of the announcement, represented nearly 15% of the total shares outstanding. During the year, the Company repurchased 313,500 shares at an average price of \$59.09 per share.

In 2006, the Company amended its floating rate secured term loans covering ten vessels. The amendments provided additional borrowings of approximately \$84 million, removed the encumbrance on one of its vessels, reduced the applicable interest rates and extended the maturity dates of certain of the loans.

### *Active Asset Management*

In furtherance of the Company's strategy to balance the mix of owned and chartered-in tonnage and to capitalize on a strong market for second-hand tonnage, the Company entered into a number of transactions whereby it sold or sold and leased-back vessels during the year. Fleet disposition activity during 2006 resulted in proceeds on vessel sales of \$259 million resulting in \$39.0 million in gains. Sale and lease-back transactions allow the Company to monetize assets in a favorable second-hand market, thereby transferring residual risk of older tonnage to third parties while retaining control of the tonnage. Amortization of deferred gains from sale and lease back transactions, which amounted to \$43.1 million in 2006, is recorded as a reduction of charter hire expense.

### **Tax Changes Benefiting OSG's International Shipping Operations**

In October 2004, Congress passed the American Jobs Creation Act of 2004 which, for taxable years beginning in 2005, reinstates the indefinite deferral of United States taxation on international shipping income until such income is repatriated to the U.S. as dividends. From 1987 through 2004, the Company's international shipping income was subject to current taxation. The tax law effectively restored the pre-1976 tax treatment of international shipping income beginning in 2005 and placed the Company's international fleet on a level playing field with its offshore competitors for the first time since 1986. For more information, see Taxation of the Company later in this section.

### **Fleet Highlights**

As of December 31, 2006, OSG's owned, operated and newbuild fleet aggregated 137 vessels. Of this total, 100 vessels are International Flag and 37 vessels are U.S. Flag. The Marshall Islands is the principal flag of registry of the Company's International Flag vessels. In the international market, the Company has one of the industry's most modern and efficient fleets. At a time when customers are demonstrating an increasingly clear preference for modern tonnage based on concerns about the environmental risks associated with older vessels, 100% of OSG's owned International Flag fleet is double hull.

Additional information about the Company's fleet, including its ownership profile, is set forth below under Operations Fleet Summary, as well as on the Company's website, [www.osg.com](http://www.osg.com).



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Fleet

	International Flag Fleet							U.S. Flag Fleet	Total
	Crude Tankers			Product Carriers					
	VLCC	Aframax	Panamax	Handysize	Panamax	Gas	Dry Bulk		
Owned	10	7	9	12*	2	0	0	20	60
Chartered-in	11	10	2	15	0	0	2	3	43
Newbuilds	0	4	0	12	0	4	0	14	34
Total	21	21	11	39	2	4	2	37	137

\* Excludes three U.S. Flag vessels that trade primarily in the international markets and are therefore reflected in the International Product Carriers reportable segment.

Newbuild Delivery Schedule

Year of Delivery	Q1	Q2	Q3	Q4
2007	U.S. Flag Product Carrier ATB Product Carrier	Product Carrier U.S. Flag Product Carrier		ATB U.S. Flag Product Carrier LNG (2)
2008	LNG (2) Product Carrier	Product Carriers (4) U.S. Flag Product Carrier	U.S. Flag Product Carrier Aframax Tanker ATB	Aframax Tankers (2)
2009	U.S. Flag Product Carrier	ATB Product Carrier U.S. Flag Product Carrier Aframax Tanker	U.S. Flag Product Carrier Product Carrier	
2010	U.S. Flag Product Carrier Product Carrier	U.S. Flag Product Carrier Product Carrier	Product Carrier	

Commercial Pools

To increase vessel utilization and thereby revenues, the Company participates in Commercial Pools with other like-minded ship owners of similar modern, well-maintained vessels. By operating a large number of vessels as an integrated transportation system, Commercial Pools offer customers greater flexibility and a higher level of service while achieving improved scheduling efficiencies. All of the Company's V-Plus and VLCC vessels are managed in the Tankers International pool which, as of December 31, 2006, operated an aggregate of 44 VLCC and V-Plus tankers that trade on long haul routes throughout the world. All of OSG's Aframax tankers are in the Aframax International pool, which at year end 2006 consisted of 34 Aframax tankers that generally trade in the Atlantic Basin, North Sea and the Mediterranean on short and medium haul routes. Nine of the Company's 11 crude Panamax tankers participate in Panamax International, which operated a total of 20 Panamaxes as of December 31, 2006 on short haul and medium haul routes between South and Central America, the U.S. and the Caribbean. These commercial ventures negotiate charters with customers primarily in the spot market. The size and scope of these pools enable them to enhance utilization rates for pool vessels by securing backhaul voyages and Contracts of Affreightment ("COAs"), thus generating higher effective TCE revenues than otherwise might be obtainable in the spot market while providing a higher level of service offerings to customers. For more information on the pools, see Operations International Fleet Operations.

Technical Operations

OSG believes that its commercial success depends in large part on the Company's compliance with quality, safety and environmental ("QSE") standards mandated by worldwide regulators and customers. The Company's integrated technical management centers in the U.S. and Europe manage its operating fleet of International Flag crude oil tankers and refined petroleum product carriers, the U.S. Flag fleet and soon the gas fleet. In addition to regular maintenance and repair,

crews onboard each vessel and OSG's technical management teams of shore side personnel are responsible for ensuring

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that the Company's fleet meets or exceeds QSE regulations and standards established by the U.S. Coast Guard, SOLAS (the International Convention for the Safety of Life at Sea) and MARPOL. This is achieved by hiring highly qualified crews and personnel, developing and deploying standardized, fleet-wide operational practices and procedures, continuous education and training and the reinforcement of Company policies through integrated systems and technology, open reporting programs and shore side support. In connection with the Company's philosophy of continuous improvement, OSG's operational integrity group, an audit and investigative function, audits both compliance by vessel crews with operating procedures and vessel compliance with environmental regulatory requirements and vessel safety and maintenance standards and responds to the Company's anonymous self reporting system of possible violations of Company policies and procedures. Furthermore, the Company's Operational Compliance Officer, who reports to the President and the Board of Directors, has independent oversight of fleet-wide vessel operating practices and procedures and global training programs. OSG believes it has one of the most comprehensive environmental compliance programs in the industry with checks and balances throughout its system. As a result of the settlement with the U.S. Department of Justice in 2006, the Company agreed to an environmental compliance program, which was substantially the same as its existing environmental management programs. For more information on the settlement, see Item 3 Legal Proceedings, later in this document.

#### **Commercial Teams**

OSG's commercial teams based in offices in London, New York, Singapore and Tampa enable customers to have access, at all times, to information about their cargo's position and status. The Company believes that the scale of its fleet, its commercial management skills and its extensive market knowledge allow it to consistently achieve better rates than smaller, independent shipowners. OSG's reputation in the marketplace is the result of longstanding relationships with its customers and business partners. Investments in technology, including database and software tools, have enabled OSG to improve the speed and quality of information it provides to its customers.

#### **Customers**

OSG's customers include major independent and state-owned oil companies, oil traders, and U.S. and international government entities. The Company believes that it distinguishes itself in the shipping market through an emphasis on service, safety and reliability and its ability to maintain and grow long-term customer relationships.

#### **Liquidity**

The Company believes that the strength of its balance sheet, and the financial flexibility that it affords, distinguishes it from many of its competitors. In 2006, stockholders' equity increased by \$331 million to \$2.2 billion and liquidity, including undrawn bank facilities, stood at more than \$2.1 billion at December 31, 2006. In 2006, OSG entered into a new \$1.8 billion unsecured credit facility, which replaced bank facilities that provided up to \$1.33 billion of unsecured financing.

Liquidity adjusted debt to capital was 14.8% at December 31, 2006, a reduction of more than nine percentage points from 24.5% as of December 31, 2005. The Company achieved this improvement after consideration of the acquisition of Maritrans Inc. in a transaction valued at \$506 million. For this purpose, liquidity adjusted debt is defined as long-term debt reduced by cash and the balance in the Capital Construction Fund.

#### **Employees**

As of December 31, 2006, the Company had 3,980 employees: 3,579 seagoing personnel and 401 shore side staff. The Company has collective bargaining agreements with three different maritime unions covering 561 seagoing personnel employed on the Company's U.S. Flag vessels. These agreements are in effect for periods ending between May 2007 and June 2015. Under the collective bargaining agreements, the Company is obligated to make contributions to pension and other welfare programs. OSG believes that it has a satisfactory relationship with its employees.

#### **FORWARD-LOOKING STATEMENTS**

This Form 10-K contains forward-looking statements regarding the outlook for tanker and articulated tug/barge markets, and the Company's prospects, including prospects for certain strategic alliances and investments. There are a number of factors, risks and uncertainties that could cause actual results to differ from the expectations reflected in these forward-looking statements, including changes in production of or demand for oil and petroleum products, either globally or in

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particular regions; greater than anticipated levels of newbuilding orders or less than anticipated rates of scrapping of older vessels; changes in trading patterns for particular commodities significantly impacting overall tonnage requirements; changes in the rates of growth of the world and various regional economies; risks incident to vessel operation, including accidents and discharge of pollutants; unanticipated changes in laws and regulations; increases in costs of operation; drydocking schedules differing from those previously anticipated; the availability to the Company of suitable vessels for acquisition or chartering-in on terms it deems favorable; changes in the pooling arrangements in which the Company participates, including withdrawal of participants or termination of such arrangements; the ability of the Company to successfully combine the operations of the Company and Maritrans Inc.; estimates of future costs and other liabilities for certain environmental matters and compliance plans; and projections of the costs needed to develop and implement the Company's strategy of being a market leader in the segments in which the Company competes. The Company assumes no obligation to update or revise any forward-looking statements.

Forward-looking statements in this Form 10-K and written and oral forward-looking statements attributable to the Company or its representatives after the date of this Form 10-K are qualified in their entirety by the cautionary statement contained in this paragraph and in other reports hereafter filed by the Company with the Securities and Exchange Commission.

### OPERATIONS

The bulk shipping of crude oil and refined and unrefined petroleum products has many distinct market segments based, in large part, on the size and design configuration of vessels required and, in some cases, on the flag of registry. Freight rates in each market segment are determined by a variety of factors affecting the supply and demand for suitable vessels. Tankers, ATBs and Product Carriers are not bound to specific ports or schedules and therefore can respond to market opportunities by moving between trades and geographical areas. The Company has established three reportable business segments: International Crude Tankers and International Product Carriers, and U.S. vessels.

The following chart reflects the percentage of TCE revenues generated by the Company's three reportable segments for each year in the three-year period ended December 31, 2006 and excludes the Company's proportionate share of TCE revenues of affiliated companies. Segment information for 2005 and 2004 has been reclassified to conform to the 2006 presentation.

	<b>Percentage of TCE Revenues</b>		
	<b>2006</b>	<b>2005</b>	<b>2004</b>
<b>International</b>			
Crude Tankers	68.9%	69.6%	82.7%
Product Carriers	21.7%	19.3%	4.8%
Other	1.8%	2.7%	3.2%
<b>Total International Segments</b>			
U.S.	7.6%	8.4%	9.3%
<b>Total</b>			
	100.0%	100.0%	100.0%

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The following chart reflects the percentage of income from vessel operations accounted for by each reportable segment. Income from vessel operations is before general and administrative expenses, gain on disposal of vessels and the Company's share of income from affiliated companies:

	Percentage of Income from Vessel Operations		
	2006	2005	2004
<b>International</b>			
Crude Tankers	88.5%	78.6%	90.8%
Product Carriers	14.5%	14.5%	3.4%
Other	(5.9)%	0.9%	0.4%
<hr/>			
<b>Total International Segments</b>	97.1%	94.0%	94.6%
U.S.	2.9%	6.0%	5.4%
<hr/>			
<b>Total</b>	100.0%	100.0%	100.0%

For additional information regarding the Company's three reportable segments for the three years ended December 31, 2006, and reconciliations of (i) time charter equivalent revenues to shipping revenues and (ii) income from vessel operations for the segments to income before federal income taxes, as reported in the consolidated statements of operations, see Management's Discussion and Analysis of Financial Condition and Results of Operations set forth in Item 7, and Note D to the Company's consolidated financial statements set forth in Item 8.

The Other International segment for 2006 reflects a \$27 million increase in the reserve for the settlement of investigations by the U.S. Department of Justice. The increase in the relative contribution of International Product Carriers to TCE revenues and income from vessel operations in 2006 and 2005 compared with 2004 reflects the addition of 26 product carriers as a result of the Stelmar acquisition in 2005. Revenues from International Crude Tankers are derived principally from voyage charters and are, therefore, significantly affected by prevailing spot rates.

In contrast to the International Crude Tankers, revenues from International Product Carriers and the vessels included in the U.S. reportable segment are derived principally from time charters generating a more predictable level of TCE earnings. Accordingly, the relative contributions of the Handysize Product Carriers and the U.S. segment's vessels to consolidated TCE revenues and to consolidated income from vessel operations are influenced by the level of freight rates then existing in the international market for crude oil tankers, increasing when such rates decrease and decreasing when such rates increase. The reduction in the relative contribution of the vessels of the U.S. segment also reflects the sale of all four U.S. Flag Crude Tankers between February 2004 and year end 2005.

### Charter Types

The Company believes that by balancing the mix of TCE revenues generated by voyage charters and time charters, the Company is able to maximize its financial performance throughout shipping cycles.

#### *Spot Market*

Voyage charters, including vessels operating in Commercial Pools that predominantly operate in the spot market, constituted 69% of the Company's TCE revenues in 2006 and 2005 and 85% in 2004. The above information is based, in part, on information provided by the pools or commercial ventures in which OSG participates. Accordingly, the Company's shipping revenues are significantly affected by prevailing spot rates for voyage charters in the markets in which the Company's vessels operate. Spot market rates are highly volatile. Rates are determined by market forces such as local and worldwide demand for the commodities carried (such as crude oil or petroleum products), volumes of trade, distances that the commodities must be transported, and the amount of available tonnage both at the time such tonnage is required and over the period of projected use. Seasonal trends greatly affect world oil consumption and consequently vessel demand. While trends in consumption vary with season, peaks in demand quite often precede seasonal consumption peaks as refiners and suppliers try to anticipate consumer demand. Seasonal peaks in oil demand are principally driven by increased demand prior to Northern Hemisphere winters, as heating oil consumption increases, and increased demand for gasoline prior to the summer driving season in the U.S. Available tonnage is affected over time, by

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the volume of newbuilding deliveries, the removal (principally through scrapping) of existing vessels from service, and by the greater efficiency of modern tonnage. Scrapping is affected by the level of freight rates, by the level of scrap prices and by international and U.S. governmental regulations that require the maintenance of vessels within certain standards and mandate the retirement of vessels lacking double hulls.

### *Time Charter Market*

A significant portion of the Company's U.S. Flag fleet, its International Flag Product Carrier fleet and upon delivery, the LNG fleet is, or will be, on time charters, providing a significant and predictable level of earnings, which is not subject to fluctuations in spot-market rates. Time charters constituted 31% of the Company's TCE revenues in 2006 and 2005 and 15% in 2004. Some of the Company's older chartered-in vessels are chartered through the remainder of their commercial lives.

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**Fleet Summary**

As of December 31, 2006, OSG's International Flag and U.S. Flag operating fleet consisted of 103 vessels, 42% of which are chartered-in under operating or capital leases, the balance of which is owned. In order to maximize returns on invested capital, particularly during periods when newbuilding prices and second-hand prices are near all-time highs, the Company charters-in tonnage, enabling it to expand its fleet without making additional capital commitments. Vessels chartered-in may be Bareboat Charters (where OSG is responsible for all Vessel Expenses) or Time Charters (where the shipowner pays Vessel Expenses).

Vessel Type	Vessels Owned		Vessels Chartered-in		Total at December 31, 2006		
	Number	Weighted by Ownership	Number	Weighted by Ownership	Total Vessels	Vessels Weighted by Ownership	Total Dwt
<b>Operating Fleet</b>							
VLCC (including V-Plus)	10	10	11	7.25	21	17.25	6,693,861
Aframax	7	7	10	7.6	17	14.6	1,776,413
Panamax	9	9	2	2	11	11	764,083
<i>International Flag Crude Tankers</i>	26	26	23	16.85	49	42.85	9,234,357
Panamax	2	2			2	2	140,626
Handysize	12	12	15	15	27	27	1,176,834
<i>International Flag Product Carriers</i>	14	14	15	15	29	29	1,317,460
<i>International Flag Dry Bulk Carriers</i>			2	2	2	2	319,843
<i>Total International Flag Operating Fleet</i>	40	40	40	33.85	80	73.85	10,871,660
Handysize Product Carriers	6	6	2	2	8	8	357,217
Clean ATBs	8	8			8	8	212,981
<b>Lightering:</b>							
ATBs	2	2			2	2	90,908
Crude Carrier	1	1			1	1	39,213
Dry Bulk Carriers and Car Carrier	3	3	1	1	4	4	110,892
<i>Total U.S. Flag Operating Fleet</i>	20	20	3	3	23	23	811,211
<i>Total Operating Fleet</i>	60	60	43	36.85	103	96.85	11,682,871
<b>Newbuild Fleet</b>							
<b>International Flag:</b>							
Aframax Crude Tankers	4	4			4	4	456,000
Handysize Product Carriers	2	2	10	10	12	12	591,350
<b>U.S. Flag:</b>							
Product Carriers			10	10	10	10	460,000
Clean ATB*	1	1			1	1	29,540
Lightering ATBs	3	3			3	3	134,511
<b>Total Newbuild Fleet</b>	10	10	20	20	30	30	1,671,401
<b>Crude Tankers, ATBs, Product Carriers and Dry Bulk Carriers</b>	70	70	63	56.85	133	126.85	13,354,272
Newbuild LNG Carriers	4	2			4	2	864,800cbm
<b>Total Operating and Newbuild Fleet</b>	74	72	63	56.85	137	128.85	

\* Being double hulled

OSG has one of the youngest International Flag fleets in the industry. The Company believes its modern, well maintained fleet is a significant competitive advantage in the global market. The table below reflects the average age of the Company's owned International Flag fleet in comparison with the world fleet.

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Vessel Type	Average Age of OSG's Owned Fleet at 12/31/06	Average Age of OSG's Owned Fleet at 12/31/05	Average Age of World Fleet at 12/31/06*
VLCC (including V-Plus)	5.9 years	5.7 years	9.1 years
Aframax	8.2 years	8.1 years	9.3 years
Panamax (crude oil and product carriers)	3.8 years	2.8 years	9.8 years
Handysize Product Carrier	5.9 years	4.9 years	12.4 years

\*

Source: Clarkson database as of January 1, 2007

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## International Fleet Operations

### *Crude Oil Tankers*

In order to enhance vessel utilization and TCE revenues, the Company has placed its V-Plus, VLCC and Aframax tankers as well as a number of Panamax tankers into commercial ventures that are responsible for the Commercial Management of these vessels. The pools collect revenue from customers, pay voyage-related expenses, and distribute TCE revenues to the participants, after deducting administrative fees, according to formulas based upon the relative carrying capacity, speed, and fuel consumption of each vessel.

*Tankers International* Tankers International was formed in December 1999 by OSG and other leading tanker companies in order to pool the commercial operation of their modern VLCC fleets. As of December 31, 2006, Tankers International had eight participants and managed a fleet of 44 modern VLCCs and V-Pluses that trade throughout the world, including all 21 (17.25, weighted by ownership) of the Company's V-Plus and VLCC owned and chartered-in vessels.

Tankers International performs the Commercial Management of its participants' vessels. The large number of vessels managed by Tankers International gives it the ability to enhance vessel utilization through backhaul cargoes and COAs, thereby generating greater TCE revenues. In recent years, crude oil shipments from West Africa to Asia have expanded, increasing opportunities for vessels otherwise returning in ballast (i.e., without cargo) from Europe and North America to load cargoes in West Africa for delivery in Asia. Such combination voyages are used to maximize vessel utilization by minimizing the distance vessels travel in ballast.

By consolidating the Commercial Management of its substantial fleet, Tankers International is able to offer its customers access to an expanded fleet of high-quality VLCCs and V-Pluses. The size of the fleet enables Tankers International to become the logistics partner of major customers, providing new and improved tools to help them better manage their shipping programs, inventories and risk.

*Aframax International* Since 1996, the Company and PDV Marina S.A., the marine transportation subsidiary of the Venezuelan state-owned oil company, have pooled the Commercial Management of their Aframax fleets. As of December 31, 2006, there were six participants in Aframax International and the pool Commercially Managed 34 vessels, including all 17 (14.6, weighted by ownership) of the Company's owned and chartered-in vessels. Aframax International's vessels generally trade in the Atlantic Basin, North Sea and the Mediterranean. The Aframax International pool has been able to enhance vessel utilization with backhaul cargoes and COAs, thereby generating higher TCE revenues than would otherwise be attainable in the spot market.

*Panamax International* Panamax International was formed in April 2004 and provides the Commercial Management of the Panamax fleets of its three participants. As of December 31, 2006, Panamax International managed a fleet of 20 modern Panamaxes, which includes five of the Company's Panamaxes, as well as four that are time chartered to one of the pool partners.

### *Product Carriers*

International Product Carriers constitutes one of the Company's reportable business segments and is made up of a diverse International Flag and U.S. Flag fleet that transport refined petroleum products worldwide. The fleet, consisting of 30 medium-range Product Carriers and two long-range Panamax coated tankers ("LR1"), gives OSG the ability to provide a broad range of services to global customers. Refined petroleum product cargoes are transported from refineries to consuming markets and are characterized by both long- and short-haul routes. The market is driven by global refinery capacity, changes in consumer demand and product specifications and cargo arbitrage opportunities. The Company's expansion of its Product Carrier fleet is consistent with its balanced growth strategy and was built upon a commercial and technical platform of operating a core fleet of Handysize Product Carriers by expanding and growing revenue and earnings in a market sector with more predictable earnings characteristics.

In contrast to the crude oil tanker market, the refined petroleum trades are more complex due to the diverse nature of product cargoes, which include gasoline, diesel, jet fuel, home heating oil, vegetable oils and easy chemicals. The trades require crews to have specialized certifications. Customer vetting requirements can be more rigorous and, in general, vessel operations are more complex due to the fact that refineries can be in closer proximity to importing nations, resulting in more frequent port calls and discharging, cleaning and loading operations than crude oil tankers.

OSG has opportunistically expanded its commercial footprint in the Product Carrier segment through acquisitions, newbuildings, chartering-in of vessels and commercial alliances.

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OSG trades two of its Handysize Product Carriers in the Clean Products International Pool, a regional Commercial Pool formed in 2006 with Ultragas Group. The pool is comprised of four vessels and concentrates on triangulation trades in South America.

Since 2005, OSG has ordered or chartered-in from third parties 14 newbuild Handysize Product Carriers. Delivery of these vessels began in 2006 and will continue through 2010. These newbuilds are an important part of the business unit's strategy to modernize and expand its fleet, and offset redeliveries of older, chartered-in vessels scheduled for 2008 and 2009. Of the Product Carrier newbuild program, all except one of the vessels will be IMO III compliant, allowing for increased flexibility when switching between cargo grades.

On January 20, 2005, OSG acquired Stelmar Shipping Ltd. ("Stelmar"), a leading provider of petroleum product and crude oil transportation services. Stelmar's fleet of 40 vessels included 24 owned and chartered-in Handysize Product Carriers. The fleet and a technical management center based in Athens, Greece, significantly expanded the Company's commercial footprint and ability to compete in Atlantic Basin trades.

Three of the four U.S. Flag vessels that participate in the U.S. government's Maritime Security Program, the Overseas Maremar, the Overseas Luxmar and the Overseas Ambermar, are included in the International Product Carrier unit. For detailed information on the Maritime Security Program, see U.S. Flag Fleet Operations, Maritime Security Program later in this section.

### *Gas*

Gas constitutes one of the Company's business units, which will transport two important energy sources: liquefied natural gas and compressed natural gas. The Company entered each of these energy sectors with strategic partners, a tactic that allows OSG to gain experience in each sector prior to committing to more significant expansion. The expansion into the gas market further enhances the Company's fixed revenue and earnings base, since both CNG and LNG markets are characterized by long-term time-charters.

OSG is constructing four 216,000 cbm LNG Carriers that will be delivered in 2007 and 2008. The Company entered this emerging energy market in November 2004, after a competitive tender process whereby Qatar Liquefied Gas Company Limited (II) selected a joint venture in which the Company has a 49.9% interest to time charter the LNG Carriers for twenty-five years, with options to extend. The joint venture between the Company and Qatar Gas Transport Company Limited (Nakilat) ordered the four vessels at a total purchase price of \$908 million. The Company will provide Technical Management for these state-of-the-art vessels. Through the award of these time charters, the Company is strategically diversifying its business, entering a market that the Company believes offers significant opportunities. For more information about the financing of the LNG Carriers, see Note F to the consolidated financial statements set forth in Item 8.

The Company entered the CNG segment in 2006 through a partnership between OSG and TransCanada CNG Technologies Ltd, a subsidiary of TransCanada Corporation. The partnership combines OSG's knowledge of marine transportation and vessel construction with TransCanada's patented technology for GTMs that is intended to enable the development of efficient and commercially viable CNG vessels. TransCanada's GTM technology utilizes a proprietary composite reinforced steel pressure container system manufactured under license from NCF Industries Inc. (U.S. and foreign patents issued and pending).

### **U.S. Flag Fleet Operations**

OSG is one of the largest commercial owners and operators of Jones Act vessels in the United States. The Company's U.S. Flag Fleet has expanded significantly in the past three years and today consists of a diverse fleet of 37 owned, operated and newbuild vessels of Handysize Product Carriers, ATBs, Dry Bulk Carriers and a Car Carrier. As a U.S.-based company, OSG is uniquely positioned to participate in the U.S. Jones Act shipping market, a trade that is not available to its foreign-based competitors. Under the Jones Act, shipping between U.S. ports, including the movement of Alaskan crude oil to U.S. ports, is reserved for U.S. Flag vessels that are built in the U.S. and owned by U.S. companies, more than 75% owned and controlled by U. S. citizens. The Jones Act regulations, coupled with tax law changes in the American Jobs Creation Act of 2004, has enabled OSG to significantly invest in and expand its U.S. Fleet business.

*ATBs* In November 2006, OSG acquired Maritrans Inc., a leading U.S. Flag crude oil and petroleum product shipping company that owned and operated one of the largest fleets of double hull Jones Act vessels serving the East and U.S. Gulf coastwise trades. This strategic acquisition gave OSG a presence in all major U.S. trading routes; intra U.S. Gulf,

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U.S. Gulf to the East Coast, U.S. Gulf to the West Coast, the Alaskan North Slope trades and the Delaware Bay. In addition, the acquisition provided for a qualifying use of OSG's Capital Construction Fund towards the acquisition of construction contracts for three ATBs, which will be used for lightering services in the Delaware Bay. The Company anticipates withdrawing approximately \$292 million through 2008 for this purpose.

*Jones Act Product Carrier Newbuild Order* In June 2005, OSG signed agreements to bareboat charter-in 10 Jones Act Product Carriers to be constructed by Aker Philadelphia Shipyard, Inc. The unique market dynamic of a declining Jones Act single hull fleet in the United States as a result of the U.S. Oil Pollution Act of 1990 ("OPA 90"), coupled with the expected continued growth in demand by U.S. consumers for crude oil and petroleum products transported by sea, served as the basis for OSG placing the series order for the product carriers prior to securing employment for the vessels. OSG has chartered-in each vessel for initial terms of five and seven years commencing on delivery of each vessel. The Company has extension options for the life of the vessels. As of December 31, 2006, OSG has entered into long-term time charters-out for nine of these 10 vessels. The vessels under construction will deliver between 2007 through 2010.

*Alaskan North Slope Trade* OSG has a significant presence in the Alaskan North Slope trade through its 37.5% equity interest in Alaska Tanker Company, LLC ("ATC"), a joint venture that was formed in 1999 among OSG, BP p.l.c. ("BP") and Keystone Shipping Company ("Keystone"), to support BP's Alaskan crude oil transportation requirements. The Company's participation in ATC provides it with the ability to earn additional income (incentive hire) based upon ATC's meeting certain predetermined performance standards. Such income, which is included in equity in income of affiliated companies, amounted to \$6.8 million in 2006, \$8.1 million in 2005 and \$7.1 million in 2004.

*Dry Bulk Cargo* The Company's U.S. Flag Dry Bulk Carriers qualify to participate in the carriage of U.S. government cargoes. The Merchant Marine Act of 1936, as amended, requires that preference be given to U.S. Flag vessels, if available at reasonable rates, in the shipment of at least half of all U.S. government-generated cargoes and 75% of all food-aid cargoes.

*Maritime Security Program* Since late 1996, the Company's U.S. Flag Pure Car Carrier has participated in the U.S. Maritime Security Program (the "Program"), which ensures that militarily useful U.S. Flag vessels are available to the U.S. Department of Defense in the event of war or national emergency. In 2005, the Company signed four agreements with the Maritime Administrator of the Department of Transportation pursuant to which the Company entered three reflagged U.S. Flag Product Carriers and re-entered its U.S. Flag Pure Car Carrier into the Program. The terms of the three agreements relating to the reflagged Product Carriers are four years, subject to extension to a total of ten years in the event that the Company is awarded certain construction subsidies under the National Defense Tanker Vessel Construction Program ("NDTVCP") and substitutes appropriate newbuild vessels constructed with such subsidies for the reflagged Product Carriers. Congressional funding of the NDTVCP has not been approved and there can be no assurance that Congress will provide such construction subsidies, that such subsidies will be awarded to the Company or that terms of these agreements will be extended if the Company does not substitute newbuild vessels constructed with such subsidies. Under the Company's ten-year agreement relating to the Pure Car Carrier, the vessel will continue in the Program through 2007, at which time the Company will need to substitute a modern U.S. Flag Car Carrier into the Program. Under the Program, the Company receives approximately \$2.6 million per year for each vessel through 2008, \$2.9 million per year for each vessel from 2009 through 2011, and \$3.1 million per year for each vessel from 2012 through 2016, subject in each case to annual Congressional appropriations.

*Capital Construction Fund* To encourage private investment in U.S. Flag vessels, the Merchant Marine Act of 1970 (the "Act") permits deferral of taxes on earnings from U.S. Flag vessels deposited into a Capital Construction Fund and amounts earned thereon, which can be used for the construction or acquisition of, or retirement of debt on, qualified U.S. Flag vessels (primarily those limited to foreign, Great Lakes, and noncontiguous domestic trades). The Company is a party to an agreement under such Act. Under the agreement, the general objective is for U.S. Flag vessels to be constructed or acquired through the use of assets accumulated in the fund. If the agreement is terminated or amounts are withdrawn from the Capital Construction Fund for non-qualified purposes, such amounts will then be subject to federal income taxes. Monies can remain tax-deferred in the fund for a maximum period of 25 years (commencing January 1, 1987 for deposits prior thereto). The Company had approximately \$316 million in its Capital Construction Fund as of December 31, 2006. The Company's balance sheet at December 31, 2006 includes a liability of approximately \$99 million for deferred taxes on the fund deposits and earnings thereon.

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### Investments in Affiliated Companies

The following chart reflects the percentage of income of investments in joint ventures and other investments accounted for using the equity method by each reportable segment.

	Percentage of Income of Equity Method Investments		
	2006	2005	2004
<b>International</b>			
Crude Tankers	66.6%	82.2%	84.4%
Other	3.1%	(0.6%)	
<b>Total International Segments</b>			
U.S.	30.3%	18.4%	15.6%
Total	100.0%	100.0%	100.0%

In October 2005, the Company sold seven tankers (three VLCCs and four Aframax) to Double Hull Tankers, Inc. ("DHT") in connection with DHT's initial public offering. These vessels are time chartered back to OSG at fixed rates for initial periods of five to six and one-half years. The charters provide for the payment of additional hire, on a quarterly basis, by OSG when the aggregate revenue earned by these vessels for the Company exceeds the sum of the basic hire paid during the quarter by the Company, as it did in 2006 and in the fourth quarter of 2005.

As a result of the 2005 sales of Front Tobago (a VLCC in which the Company held a 30% joint venture interest) and the Compass I (an Aframax in which OSG held a 50% joint venture interest) and the Company's purchase of its partner's 50.1% interest in a joint venture that owned four V-Pluses (see discussion below), the only operating vessels held in companies accounted for by the equity method at December 31, 2006 and 2005 were those held through DHT, all of which are on time charters to OSG, with profit sharing.

In 2004, the Company completed a transaction with its partner covering six joint venture companies, each of which owned a VLCC. This transaction provided for an exchange of joint venture interests that resulted in the Company owning 100% of the Dundee, Sakura I and Tanabe, and the joint venture partner owning 100% of the Edinburgh, Ariake and Hakata. The results of the Dundee, Sakura I and Tanabe are included in the International Crude Tankers segment from the effective date of the transaction.

In July 2004, a joint venture in which the Company has a 49.9% interest, acquired four double hull V-Pluses. The four V-Pluses, which are the only double hull V-Pluses in the world, are capable of carrying up to 3.2 million barrels of crude oil, more than 50% greater than VLCCs, at a lower delivered cost per barrel. These four vessels incorporate many design features intended to extend their trading lives to 40 years and enhance their safety and efficiency in the long haul crude trade. On June 1, 2005, a subsidiary of OSG acquired its partner's 50.1% interest in this joint venture, then sold two of the four V-Pluses to the former joint venture partner in exchange for cash. The results of the two V-Pluses the Company owns, TI Africa and TI Oceania, are included in the International Crude Tankers segment from the effective date of the transaction.

### COMPETITION

The shipping industry is highly competitive and fragmented with OSG competing with other owners of U.S. and International Flag tankers and dry cargo ships. Competitors include other independent shipowners and integrated oil companies and state owned entities with their own fleets, oil traders with logistical operations, and pipelines.

OSG's vessels compete with all other vessels of a size and type required by the customer that can be available at the date specified. In the spot market, competition is based primarily on price, although charterers are becoming increasingly more selective with respect to the quality of the vessel they hire considering other key factors such as the vessel age, the reliability and quality of operations and preference for modern double hull vessels based on concerns about environmental risks associated with older vessels. Consequently, owners of large modern double hull fleets have gained

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a competitive advantage over owners of older fleets. In the time charter market, factors such as the age and quality of the vessel and reputation of its owner and operator tend to be more significant when competing for business.

As of December 31, 2006, OSG's fleet of VLCCs and V-Pluses is commercially managed through Tankers International. Tankers International, with a total of 44 VLCCs as of December 31, 2006, is a leading player in this highly competitive and fragmented market. Its main competitors include Frontline Ltd., Mitsui OSK Lines, Ltd., Nippon Yusen Kabushiki Kaisha and VELA International Marine Ltd., the shipping arm of the Saudi Arabian oil company.

OSG also operates as part of Aframax International, which consists of 34 Aframaxes trading primarily in the Atlantic Basin, North Sea, Baltic and Black Sea areas and in the Mediterranean. Aframax International is one of the three largest operators in this fragmented market sector. Aframax International's main competitors include Teekay Shipping Corporation, Malaysian International Shipping Corporation Berhad, Novorossiysk Shipping Company, Sigma Tankers Heidmar Inc. and British Petroleum Shipping Ltd.

OSG's main competitors in the highly fragmented Panamax trade include owners and pool operators. Panamax International commercially manages 20 double hull vessels. Main competitors include Star Tankers Heidmar Inc., A/S Dampskibsselskabet Torm, Jacob-Scorpio Pool Management S.A.M. as well as Glencore International AG and China Shipping Group.

In the Handysize Product Carrier segment, OSG owns or charters-in a fleet of 27 vessels that competes in a highly fragmented market. Main competitors include Glencore International AG, Handytankers K/S, Vitol Group, OMI Corporation, Trafigura, A/S Dampskibsselskabet Torm, Sovcomflot OAO and Novorossiysk Shipping Company.

The U.S. Jones Act restricts U.S. point-to-point seaborne shipments to vessels operating under U.S. Flag that were built in the U.S., manned by U.S. crews and at least 75% owned and operated by U.S. citizens. OSG's primary competitors are operators of U.S. Flag oceangoing barges and tankers, such as Seacor Holdings Inc. and U.S. Shipping Partners L.P. and operators of refined product pipelines, such as the Colonial and Plantation pipeline systems that transport refined petroleum products directly from refineries to markets.

### ENVIRONMENTAL AND SECURITY MATTERS RELATING TO BULK SHIPPING

Government regulation significantly affects the operation of the Company's vessels. OSG's vessels are subject to international conventions, national, state and local laws and regulations in force in the countries in which such vessels may operate or are registered.

The Company's vessels undergo regular and rigorous in-house safety reviews. In addition, a variety of governmental and private entities subject the Company's vessels to both scheduled and unscheduled inspections. These entities include local port state control authorities (U.S. Coast Guard, harbor master or equivalent), Classification Societies, flag state administration (country of registry) and charterers, particularly terminal operators and oil companies. Certain of these entities require OSG to obtain permits, licenses and certificates for the operation of the Company's vessels. Failure to maintain necessary permits or approvals could require OSG to incur substantial costs or temporarily suspend operation of one or more of the Company's vessels.

The Company believes that the heightened level of environmental and quality concerns among insurance underwriters, regulators and charterers is leading to greater inspection and safety requirements on all vessels and may accelerate the scrapping of older tankers throughout the industry. Increasing environmental concerns have created a demand for tankers that conform to the stricter environmental standards. The Company is required to maintain operating standards for all of its tankers emphasizing operational safety, quality maintenance, continuous training of its officers and crews and compliance with international and U.S. regulations. OSG believes that the operation of its vessels is in compliance with applicable environmental laws and regulations; however, because such laws and regulations are frequently changed and may impose increasingly stringent requirements, OSG cannot predict the ultimate cost of complying with these requirements, or the impact of these requirements on the resale value or useful lives of its tankers.

On December 19, 2006, OSG and the U.S. Department of Justice reached a comprehensive settlement regarding violations concerning the Company's handling of waste oils and maintenance of books and records related thereto. For more information on the settlement, see Item 3 Legal Proceedings later in this document.

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## International Environmental and Safety Restrictions and Regulations

### *Phase Out of Non Double Hull Tankers:*

In April 2001, the International Maritime Organization ("IMO") adopted regulations under the International Convention for the Prevention of Pollution from Ships, or MARPOL, requiring new tankers of 5,000 dwt and over, contracted for construction since July 6, 1993, to have double hull, mid-deck or equivalent design. At that time the regulations also required the phase out of non double hull tankers by 2015, with tankers having double sides or double bottoms permitted to operate until the earlier of 2017 or when the vessel reaches 25 years of age. Existing single hull tankers were required to be phased out unless retrofitted with double hull, mid-deck or equivalent design no later than 30 years after delivery. These regulations were adopted by over 150 nations, including many of the jurisdictions in which the Company's tankers operate. Subsequent amendments to the MARPOL regulations accelerated the phase out of single hull tankers to 2005 for Category I vessels and 2010 for Category II vessels. Category I vessels are crude oil tankers of 20,000 dwt and above and product carriers of 30,000 dwt and above that are pre-MARPOL Segregated Ballast Tanks ("SBT") carriers. Category II tankers are crude oil tankers of 20,000 dwt and above and product carriers of 30,000 dwt and above that are post-MARPOL SBT tankers. In addition, a Condition Assessment Scheme ("CAS") will apply to all single hull tankers 15 years or older. Flag states, however, may permit the continued operation of Category II tankers beyond 2010, subject to satisfactory CAS results, but only to 2015 or 25 years of age, whichever comes earlier. Category II tankers fitted with double bottoms or double sides not used for the carriage of oil will be permitted to trade beyond 2010 to 25 years of age, subject to the approval of the flag state. Although flag states may grant life extensions to Category II tankers, port states are permitted to deny entry to their ports and offshore terminals to single hull tankers operating under such life extensions after 2010, and to double sided or double bottomed tankers after 2015.

MARPOL Regulation 13H banned the carriage of heavy grade oils in single hull tankers of more than 5,000 dwt after April 5, 2005, except that flag states may permit Category II tankers to continue to carry heavy grade oil beyond 2005, subject to satisfactory CAS results. This regulation predominantly affected heavy crude oil from Latin America, as well as heavy fuel oil, bitumen, tar and related products.

The IMO may adopt additional regulations in the future that could further restrict the operation of single hull vessels.

European Union ("EU") regulation (EC) No. 417/2002, which was introduced in the wake of the sinking of the Erika off the coast of France in December 1999, provided a timetable for the phase out of single hull tankers from EU waters. In 2003, in response to the Prestige oil spill in November 2002, the EU adopted legislation that (a) banned all Category I single hull tankers over the age of 23 years immediately, (b) phased out all other Category I single hull tankers in 2005 and (c) prohibits all single hull tankers used for the transport of oil from entering its ports or offshore terminals after 2010, with double sided or double bottomed tankers permitted to trade until 2015 or until reaching 25 years of age, whichever comes earlier. The EU, following the lead of certain EU nations such as Italy and Spain, also banned all single hull tankers carrying heavy grades of oil from entering or leaving its ports or offshore terminals or anchoring in areas under its jurisdiction.

Many users of oil transportation services operating around Europe are showing a willingness to pay a higher freight rate for double hull tankers than for single hull tankers. It is becoming increasingly more difficult to obtain clearance for single hull tankers from many countries and oil terminals.

OSG's International Flag tanker fleet is comprised of modern double hull vessels, except for 13 chartered-in Handysize Product Carriers, which do not qualify as double hull for MARPOL or EU purposes. The direct impact to the Company of the revised and accelerated IMO phase out schedule will be limited, as all of the Company's crude oil tankers, and all but these 13 chartered-in International Flag Product Carriers, are double hull, and the charters-in expire prior to the date of the respective vessels' IMO phase out. However, because six of these 13 vessels are not already chartered out through the end of their respective charters-in, they are less likely to command premium rates when their current time charters out end. The Company's four double bottom U.S. Flag Product Carriers and two single hull barges (one of which is scheduled to be rebuilt to double hull specifications during 2007) participate in the U.S. Jones Act trades and are therefore not affected by the IMO phase-out schedule. The U.S. has not adopted the 2001 amendments to the MARPOL regulations, which were viewed as less restrictive than OPA 90 regulations that were already in place.

The IMO has also negotiated international conventions that impose liability for oil pollution in international waters and a signatory's territorial waters.

### *Other International Environmental and Safety Regulations:*

Under the International Safety Management Code, or ISM Code, promulgated by the IMO, vessel operators are required to develop an extensive safety management system that includes, among other things, the adoption of a safety and environmental protection policy setting forth instructions and procedures for operating their vessels safely and describing procedures for responding to emergencies. OSG has developed such a safety management system. The ISM Code also requires that vessel operators obtain a safety management certificate for each vessel they operate. This certificate evidences compliance by a vessel's management with code requirements for a safety management system. No vessel can obtain a certificate unless its operator has been awarded a document of compliance, issued by the flag state of that vessel, under the ISM Code.

All of the Company's vessels are certified under the standards promulgated by the International Standards Organization in ISO 9001 in 2000 and ISO 14001 in 2004 and those promulgated by the IMO in its International Safety Management ("ISM") safety and pollution prevention protocols. The ISM Code requires a document of compliance to be obtained for the vessel manager and a safety management certificate to be obtained for each vessel that it operates. The Company has obtained documents of compliance for its shore side offices that have responsibility for vessel management and safety management certificates for each of the vessels that they manage. These documents of compliance and safety management certificates must be verified or renewed periodically (annually or less frequently, depending on the type of document) in accordance with the ISM Code. Noncompliance with the ISM Code and other IMO regulations may subject the shipowner or charterer to increased liability, 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 U.S. Coast Guard and EU authorities have indicated that vessels not in compliance with the ISM Code will be prohibited from trading with U.S. and EU ports.

Although the U.S. is not a party to these conventions, many countries have ratified and follow the liability plan adopted by the IMO and set out in the International Convention on Civil Liability for Oil Pollution Damage of 1969. Under this convention, depending on whether the country in which the damage results is a party to the 1992 Protocol to the International Convention on Civil Liability for Oil Pollution Damage, 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. Under an amendment to the 1992 Protocol that became effective on November 1, 2003, for vessels of 5,000 to 140,000 gross tons (a unit of measurement for the total enclosed spaces within a vessel), liability will be limited to approximately \$6.7 million plus \$943 for each additional gross ton over 5,000. For vessels over 140,000 gross tons, liability will be limited to approximately \$134 million. As the convention calculates liability in terms of a basket of currencies, these figures are based on currency exchange rates on February 6, 2007. Under the 1969 Convention, the right to limit liability is forfeited where the spill is caused by the owner's actual fault; under the 1992 Protocol, a shipowner cannot limit liability where the spill is caused by the owner's intentional or reckless conduct. Vessels trading to states that are parties to these conventions must provide evidence of insurance covering the liability of the owner. In jurisdictions where the International Convention on Civil Liability for Oil Pollution Damage 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 that convention. The Company believes that its P&I insurance will cover any liability under the plan adopted by the IMO. See the discussion of Insurance below.

IMO regulations also require owners and operators of vessels to adopt Shipboard Oil Pollution Emergency Plans, or SOPEPs. Periodic training and drills for response personnel and for vessels and their crews are required. In addition to SOPEPs, OSG has adopted Shipboard Marine Pollution Emergency Plans, or SMPEPs, which cover potential releases not only of oil but of any noxious liquid substances (known as NLSs).

The EU has adopted legislation that: (1) bans manifestly sub-standard vessels (defined as those over 15 years old that have been detained by port authorities at least twice in a six month period) from European waters, creates an obligation for port states to inspect at least 25% of vessels using these ports annually and provides for increased surveillance of vessels posing a high risk to maritime safety or the marine environment, and (2) provides the EU with greater authority and control over Classification Societies, including the ability to seek to suspend or revoke the authority of negligent societies. In addition, the EU is considering the adoption of criminal sanctions for certain pollution events, such as the unauthorized discharge of tank washings. Certain member states of the European Union, by virtue of their national

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legislation, already impose criminal sanctions for pollution events under certain circumstances. It is impossible to predict what additional legislation or regulations, if any, may be promulgated by the EU or any other country or authority.

Annex VI to MARPOL, which was designed to address air pollution from ships and which became effective internationally on May 19, 2005, sets limits on sulfur dioxide and nitrogen oxide emissions from ship exhausts and prohibits deliberate emissions of ozone depleting substances, such as chlorofluorocarbons. Annex VI also imposes a global cap on the sulfur content of fuel oil and allows for specialized areas to be established internationally with more stringent controls on sulfur emissions. For vessels over 400 gross tons, Annex VI imposes various survey and certification requirements. While the U.S. has not yet ratified Annex VI, vessels operating internationally are subject to the requirements of Annex VI in those countries that have implemented its provisions, and the Company's vessels are currently in compliance with these requirements. However, additional or new conventions, laws and regulations (including those implementing MARPOL Annex VI in the U.S., as discussed below) may be adopted that could adversely affect the Company's ability to comply with applicable air pollution regulations in the future.

### **Domestic Environmental and Safety Restrictions and Regulations**

The U.S. regulates the shipping industry with an extensive regulatory and liability regime for environmental protection and cleanup of oil spills, consisting primarily of OPA 90, and the Comprehensive Environmental Response, Compensation, and Liability Act, or CERCLA. OPA 90 affects all owners and operators whose vessels trade with the U.S. or its territories or possessions, or whose vessels operate in the waters of the U.S., which include the U.S. territorial sea and the 200 nautical mile exclusive economic zone around the United States. CERCLA applies to the discharge of hazardous substances (other than oil) whether on land or at sea. Both OPA 90 and CERCLA impact the Company's operations.

Under OPA 90, vessel owners, operators and bareboat or demise charterers are "responsible parties" who are liable, without regard to fault, for all containment and clean-up costs and other damages, including property and natural resource damages and economic loss without physical damage to property, arising from oil spills and pollution from their vessels.

In general, OPA 90 has historically limited the liability of responsible parties to the greater of \$1,200 per gross ton or \$10 million per vessel that is over 3,000 gross tons. Federal legislation signed into law on July 11, 2006 increased these limits to the greater of \$1,900 per gross ton or \$16 million per vessel that is over 3,000 gross tons (subject to possible adjustment for inflation). For OSG's vessels, the increased limits became effective on October 9, 2006. The statute specifically permits individual states to impose their own liability regimes with regard to oil pollution incidents occurring within their boundaries, and some states have enacted legislation providing for unlimited liability for discharge of pollutants within their waters. In some cases, states that have enacted this type of legislation have not yet issued implementing regulations defining vessel owners' responsibilities under these laws. CERCLA, which applies to owners and operators of vessels, contains a similar liability regime and provides for cleanup, removal and natural resource damages associated with discharges of hazardous substances (other than oil). Liability under CERCLA is limited to the greater of \$300 per gross ton or \$5 million.

These limits of liability do not apply, however, where the incident is caused by violation of applicable U.S. federal safety, construction or operating regulations, or by the responsible party's gross negligence or willful misconduct. Similarly, these limits do not apply if the responsible party fails or refuses to report the incident or to cooperate and assist in connection with the substance removal activities. OPA 90 and CERCLA each preserve the right to recover damages under existing law, including maritime tort law.

OPA 90 also requires owners and operators of vessels to establish and maintain with the U.S. Coast Guard evidence of financial responsibility sufficient to meet the limit of their potential strict liability under the statute. The U.S. Coast Guard has enacted regulations requiring evidence of financial responsibility consistent with the previous limits of liability described above for OPA 90 and CERCLA, which combined limit for vessels was increased from \$1,500 per gross ton to \$2,200 per gross ton effective October 9, 2006, when the increased liability limits under OPA 90 went into effect. Under the regulations, evidence of financial responsibility may be demonstrated by insurance, surety bond, self-insurance, guaranty or an alternative method subject to approval by the Director of the U.S. Coast Guard National Pollution Funds Center. Under OPA 90 regulations, an owner or operator of more than one vessel is required to demonstrate evidence of



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financial responsibility for the entire fleet in an amount equal only to the financial responsibility requirement of the vessel having the greatest maximum strict liability under OPA 90 and CERCLA. OSG has provided the requisite guarantees and has received certificates of financial responsibility from the U.S. Coast Guard for each of its vessels required to have one.

OSG has insurance for each of its vessels with pollution liability insurance in the amount of \$1 billion. However, a catastrophic spill could exceed the insurance coverage available, in which event there could be a material adverse effect on the Company's business.

OPA 90 calls for the elimination of all single hull vessels by the year 2010 on a phase-out schedule that is based on size and age, unless the tankers are retrofitted with double hulls. The law permits then existing single hull vessels to operate until 2015 if they discharge at deep water ports, or lighter more than 60 miles offshore.

The Company's four double bottom U.S. Flag Product Carriers will be affected by the OPA 90 phase-out schedule in 2012 and 2013; however, two of these vessels are operated under capital leases expiring in 2011, before their phase-out dates, while the other two vessels will be close to 30 years old at the dates they are first affected by the OPA 90 phase-out schedule. The Company also has two single hull U.S. Flag barges, one of which is scheduled to be rebuilt to double hull specifications during 2007, while the other will be over 33 years old when it is affected by the OPA 90 phase-out. The OPA 90 phase-out dates for the Company's non double hull International Flag Product Carriers are subsequent to their respective IMO phase-out dates.

OPA 90 also amended the Federal Water Pollution Control Act to require owners and operators of vessels to adopt vessel response plans for reporting and responding to oil spill scenarios up to a "worst case" scenario and to identify and ensure, through contracts or other approved means, the availability of necessary private response resources to respond to a "worst case discharge." The plans must include contractual commitments with clean-up response contractors in order to ensure an immediate response to an oil spill. The Company has developed and filed its vessel response plans with the U.S. Coast Guard and has received approval of such plans. The U.S. Coast Guard has announced its intention to propose similar regulations requiring certain vessels to prepare response plans for the release of hazardous substances.

OPA 90 also requires training programs and periodic drills for shore and response personnel and for vessels and their crews.

OPA 90 does not prevent individual U.S. states from imposing their own liability regimes with respect to oil pollution incidents occurring within their boundaries. In fact, most U.S. states that border a navigable waterway have enacted environmental pollution laws that impose strict liability on a person for removal costs and damages resulting from a discharge of oil or a release of a hazardous substance. These laws are in some cases more stringent than U.S. federal law.

In addition, the U.S. Clean Water Act, or CWA, 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 the more recent OPA and CERCLA, discussed above. The U.S. Environmental Protection Agency, or EPA, has exempted the discharge of ballast water and other substances incidental to the normal operation of vessels in U.S. ports from Clean Water Act permitting requirements. However, on March 30, 2005, a U.S. District Court ruled that the EPA exceeded its authority in creating an exemption for ballast water. On September 18, 2006, the court 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, directing EPA to develop a system for regulating all discharges from vessels by that date. Although the EPA has indicated that it will appeal this decision, if the exemption is repealed, the Company's vessels would be subject to Clean Water Act permitting requirements that could include ballast water treatment obligations that could increase the cost of operating in the United States. For example, repeal of the ballast water exemption could require the installation of equipment on the Company's vessels to treat ballast water before it is discharged or the implementation of other port facility disposal arrangements or procedures at potentially substantial cost and/or otherwise restrict the Company's vessels from entering U.S. waters.

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## Domestic Air Emissions Standards

The U.S. has not yet ratified MARPOL Annex VI, H.R. 5811, which was passed by the House of Representatives in 2006, but was not approved by the Senate before the end of the Congressional term. Congress is expected to consider implementation of Annex VI in 2007. Annex VI imposes rigorous record keeping requirements, and H.R. 5811 would have allowed the U.S. government to invoke criminal penalties for record keeping violations of Annex VI. Without knowing how Annex VI will be implemented (if at all) in the U.S., it is difficult for the Company to evaluate whether the cost of complying with Annex VI as so implemented will be material, although the Company believes that its fleet would not be impacted disproportionately compared with those of its competitors.

The U.S. Clean Air Act of 1970, as amended by the Clean Air Act Amendments of 1977 and 1990, or CAA, requires the EPA to promulgate standards applicable to emissions of volatile organic compounds and other air contaminants. OSG's vessels are subject to vapor control and recovery requirements for certain cargoes when loading, unloading, ballasting, cleaning and conducting other operations in regulated port areas. Each of the Company's vessels operating in the transport of clean petroleum products in regulated port areas where vapor control standards are required has been outfitted with a vapor recovery system that satisfies these requirements. In addition, in December 1999, the EPA issued a final rule regarding emissions standards for marine diesel engines. The final rule applies emissions standards to new engines beginning with the 2004 model year. In the preamble to the final rule, the EPA noted that it may revisit the application of emissions standards to rebuilt or remanufactured engines, if the industry does not take steps to introduce new pollution control technologies. Finally, the EPA recently entered into a settlement that will expand this rulemaking to include certain large diesel engines not previously addressed in the final rule. Adoption of such standards could require modifications to some existing marine diesel engines and may require the Company to incur capital expenditures.

Lightering activities in Delaware are subject to Title V of the CAA, and OSG is the only marine operator with a Title V permit to engage in lightering operations. The State of Delaware is in non-compliance with EPA requirements for volatile organic compounds, or VOCs. OSG's U.S. Flag lightering operations are the State of Delaware's largest single source of VOCs. The Delaware Department of Natural Resources and Environment Control, or DNREC, has prepared rules to address emissions of VOCs from lightering operations, and the Company worked closely with DNREC to craft these regulations, which the Company expects to go into effect April 2007. In cooperation with DNREC, the Company's U.S. Flag operations have engaged in a pilot project involving vapor balancing between one of its tankers, the Integrity, and "ships to be lightered." In addition, OSG has incorporated vapor control technologies in the design of the Company's new ATBs.

The CAA also requires states to draft State Implementation Plans, or SIPs, designed to attain national health-based air quality standards in major metropolitan and industrial areas. Where states fail to present approvable SIPs, or SIP revisions by certain statutory deadlines, the U.S. government is required to draft a Federal Implementation Plan. Several SIPs regulate emissions resulting from barge loading and degassing operations by requiring the installation of vapor control equipment. Where required, the Company's vessels are already equipped with vapor control systems that satisfy these requirements.

Individual states have been considering their own restrictions on air emissions from engines on vessels operating within state waters. California regulations of emissions of diesel particulate matter, nitrogen oxides and sulfur oxides from the use of certain types of engines on ocean-going vessels within California waters became effective January 1, 2007. The Company's vessels that operate in California waters are in compliance with these regulations.

## Security Regulations

As of July 1, 2004, all ships involved in international commerce and the port facilities that interface with those ships must comply with the International Ship and Port Facility Security Code ("ISPS Code"). This includes passenger ships, cargo ships over 500 gross tons, and mobile offshore drilling rigs. The ISPS Code provides a set of measures and procedures to prevent acts of terrorism, which threaten the security of passengers and crew and the safety of ships and port facilities. All of OSG's Ship Security Plans for its vessels have been approved by the appropriate regulatory authorities and have been implemented.

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All of the Company's ships have obtained an International Ship Security Certificate from a recognized security organization approved by the appropriate flag states and each vessel has developed and implemented an approved Ship Security Plan.

### **Insurance**

Consistent with the currently prevailing practice in the industry, the Company presently carries protection and indemnity ("P&I") insurance coverage for pollution of \$1.0 billion per occurrence on every vessel in its fleet. P&I insurance is provided by mutual protection and indemnity associations ("P&I Associations"). The P&I Associations that comprise the International Group insure approximately 90% of the world's commercial tonnage and have entered into a pooling agreement to reinsure each association's liabilities. Each P&I Association has capped its exposure to each of its members at approximately \$5.45 billion. As a member of a P&I Association which is a member of the International Group, the Company is subject to calls payable to the Associations based on its claim record as well as the claim records of all other members of the individual Associations of which it is a member, and the members of the pool of P&I Associations comprising the International Group. As of December 31, 2006, the Company was a member of four P&I Associations with each of its vessels insured by one of these four Associations. While the Company has historically been able to obtain pollution coverage at commercially reasonable rates, no assurances can be given that such insurance will continue to be available in the future.

The Company carries marine hull and machinery and war risk insurance, which includes the risk of actual or constructive total loss, for all of its vessels. The vessels are each covered up to at least their fair market value, with deductibles ranging from \$100,000 to \$350,000 per vessel per incident. The Company is self insured for hull and machinery claims in amounts in excess of the individual vessel deductibles up to a maximum aggregate loss of \$3,000,000 per policy year.

The Company currently maintains loss of hire insurance to cover loss of charter income resulting from accidents or breakdowns of its vessels that are covered under the vessels' marine hull and machinery insurance. Loss of hire insurance covers up to 120 days lost charter income per vessel per incident in excess of the first 60 days lost for each covered incident, which is borne by the Company.

### **Taxation of the Company**

The following summary of the principal United States tax laws applicable to the Company, as well as the conclusions regarding certain issues of tax law, are based on the provisions of the U.S. Internal Revenue Code of 1986, as amended (the "Code"), existing and proposed U.S. Treasury Department regulations, administrative rulings, pronouncements and judicial decisions, all as of the date of this Annual Report. No assurance can be given that changes in or interpretation of existing laws will not occur or will not be retroactive or that anticipated future circumstances will in fact occur. The Company's views should not be considered official, and no assurance can be given that the conclusions discussed below would be sustained if challenged by taxing authorities.

All of the Company's International Flag vessels are owned or operated by foreign corporations that are subsidiaries of OSG International, Inc., a wholly owned subsidiary of the Company incorporated in the Marshall Islands ("OIN"). These corporations have made special U.S. tax elections under which they are treated as "branches" of OIN rather than separate corporations for U.S. federal income tax purposes.

As a result of changes made by the American Jobs Creation Act of 2004 ("2004 Act"), as discussed below, for taxable years beginning after December 31, 2004, the Company is no longer required to report in taxable income on a current basis the undistributed foreign shipping income earned by OIN under the "Subpart F" provisions of the Code.

#### *Taxation to OIN of its Shipping Income: In General*

OIN derives substantially all of its gross income from the use and operation of vessels in international commerce. This income principally consists of hire from time and voyage charters for the transportation of cargoes and the performance of services directly related thereto, which is referred to herein as "shipping income."

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Shipping income that is attributable to transportation that begins or ends, but that does not both begin and end, in the U.S. will be considered to be 50% derived from sources within the United States. Shipping income attributable to transportation that both begins and ends in the United States will be considered to be 100% derived from sources within the United States. OIN does not engage in transportation that gives rise to 100% U.S. source income. Shipping income attributable to transportation exclusively between non-U.S. ports will be considered to be 100% derived from sources outside the United States. Shipping income derived from sources outside the U.S. will not be subject to any U.S. federal income tax. OIN's vessels will operate in various parts of the world, including to or from U.S. ports. Unless exempt from U.S. taxation under Section 883 of the Code, OIN will be subject to U.S. federal income taxation of 4% of its U.S. source shipping income on a gross basis without the benefit of deductions.

### *Application of Code Section 883*

Under Section 883 of the Code, OIN will be exempt from the foregoing U.S. taxation of its U.S. source shipping income if it is a "controlled foreign corporation" within the meaning of Section 957 of the Code and, under Treasury regulations that were promulgated prior to the enactment of the 2004 Act, more than 50% of OIN's shipping income is includible in the gross income of U.S. persons that own 10% or more of OIN's stock. While OIN is a controlled foreign corporation, as a result of the passage of the 2004 Act, the Company is no longer required to include OIN's undistributed shipping income in its income under Subpart F of the Code. In these circumstances, prior to a recent IRS notice, it was unclear whether the IRS would interpret the Treasury regulations as currently written in a manner that would deprive OIN of the benefits of Section 883 of the Code. The IRS has now clarified that it will interpret the Treasury regulations in a manner that will allow OIN to continue to benefit from the application of Section 883 of the Code. To the extent OIN is unable to qualify for exemption from tax under Section 883, OIN's U.S. source shipping income will become subject to the 4% gross basis tax regime described below.

### *Taxation to OSG of OIN's Shipping Income*

For taxable years beginning on or after January 1, 1987 and ending on or before December 31, 2004, the Company, as a 10% shareholder of controlled foreign corporations, was subject to current taxation on the shipping income of its foreign subsidiaries. To make U.S.-controlled shipping companies competitive with foreign-controlled shipping companies, through the passage of the 2004 Act, Congress repealed the current income inclusion by 10% shareholders of the shipping income of controlled foreign corporations. Accordingly, for years beginning on or after January 1, 2005, the Company is not required to include in income OIN's undistributed shipping income.

For taxable years beginning on or after January 1, 1976 and ending on or before December 31, 1986, the Company was not required to include in income the undistributed shipping income of its foreign subsidiaries that was reinvested in qualified shipping assets. For taxable years beginning on or after January 1, 1987, the Company is required to include in income the deferred shipping income from this period to the extent that at the end of any year the investment in qualified shipping assets is less than the corresponding amount at December 31, 1986. By virtue of the nature of OIN's business, the Company anticipates that the recognition of this deferred income will be postponed indefinitely. This is discussed in more detail in the notes to the Company's consolidated financial statements set forth in Item 8.

### *U.S. Tonnage Tax Regime*

The 2004 Act changed the U.S. tax treatment of the foreign operations of the Company's U.S. Flag vessels by allowing it to make an election to have such vessels taxed under a new "tonnage tax" regime rather than the usual U.S. corporate income tax regime. Because OSG made the tonnage tax election, its gross income for U.S. income tax purposes with respect to eligible U.S. flag vessels for 2005 and subsequent years does not include (1) income from qualifying shipping activities in U.S. foreign trade (*i.e.*, transportation between the U.S. and foreign ports or between foreign ports), (2) income from cash, bank deposits and other temporary investments that are reasonably necessary to meet the working capital requirements of qualifying shipping activities, and (3) income from cash or other intangible assets accumulated pursuant to a plan to purchase qualifying shipping assets. The Company's taxable income with respect to the operations of its eligible U.S. Flag vessels is based on a "daily notional taxable income," which is taxed at the highest U.S. corporate income tax rate. The daily notional taxable income from the operation of a qualifying vessel is 40 cents per 100 tons of the net tonnage of the vessel up to 25,000 net tons, and 20 cents per 100 tons of the net tonnage of the vessel in excess of 25,000 net tons. The taxable income of each qualifying vessel is the product of its daily notional taxable income and the number of days during the taxable year that the vessel operates in U.S. foreign trade.

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### Glossary

**Aframax** A medium size crude oil tanker of approximately 80,000 to 120,000 deadweight tons. Because of their size, Aframaxes are able to operate on many different routes, including from Latin America and the North Sea to the U.S. They are also used in lightering (transferring cargo from larger tankers, typically VLCCs, to smaller tankers for discharge in ports from which the larger tankers are restricted). Modern Aframaxes can generally transport from 500,000 to 800,000 barrels of crude oil.

**Articulated Tug Barge** ATB is the abbreviation for Articulated Tug Barge, which is a tug-barge combination system capable of operating on the high seas, coastwise and further inland. It combines a normal barge, with a bow resembling that of a ship, but having a deep indent at the stern to accommodate the bow of a tug. The fit is such that the resulting combination behaves almost like a single vessel at sea as well as while maneuvering.

**Bareboat Charter** A Charter under which a customer pays a fixed daily or monthly rate for a fixed period of time for use of the vessel. The customer pays all costs of operating the vessel, including voyage and vessel expenses. Bareboat charters are usually long term.

**CAP** The Condition Assessment Program of ABS Consulting, a subsidiary of the American Bureau of Shipping, which evaluates a vessel's operation, machinery, maintenance and structure using the ABS Safe Hull Criteria. A CAP 1 rating indicates that a vessel meets the standards of a newly built vessel.

**Capesize Bulk Carrier** A large Dry Bulk Carrier (any vessel used to carry non-liquid bulk commodities) with a carrying capacity of more than 80,000 deadweight tons that mainly transports iron ore and coal.

**Charter** Contract entered into with a customer for the use of the vessel for a specific voyage at a specific rate per unit of cargo ("Voyage Charter"), or for a specific period of time at a specific rate per unit (day or month) of time ("Time Charter").

**Classification Societies** Organizations that establish and administer standards for the design, construction and operational maintenance of vessels. As a practical matter, vessels cannot trade unless they meet these standards.

**Compressed Natural Gas or CNG** CNG is the abbreviation for compressed natural gas. CNG is a gas that has been compressed for transportation in pressurized containers and can be transported on ships, barges or trucks. In many parts of the world, gas fields that cannot be readily connected by pipeline or are not large enough to support the cost of developing LNG facilities are excellent candidates for CNG development.

**Commercial Management or Commercially Managed** The management of the employment, or chartering, of a vessel and associated functions, including seeking and negotiating employment for vessels, billing and collecting revenues, issuing voyage instructions, purchasing fuel, and appointing port agents.

**Commercial Pool** A commercial pool is a group of similar size and quality vessels with different shipowners that are placed under one administrator or manager. Pools offer participants opportunities for scheduling and other operating efficiencies such as multi-legged charters and Contracts of Affreightment and other operating efficiencies.

**Condition Assessment Scheme** An inspection program designed to check and report on the vessel's physical condition and on its past performance based on survey and IMO's International Safety Management audit reports and port state performance records.

**Contract of Affreightment or COA** COA is the abbreviation for Contract of Affreightment, which is an agreement providing for the transportation between specified points for a specific quantity of cargo over a specific time period but without designating specific vessels or voyage schedules, thereby allowing flexibility in scheduling since no vessel designation is required. COAs can either have a fixed rate or a market-related rate. One example would be two shipments of 70,000 tons per month for the next two years at the prevailing spot rate at the time of each loading. Another example is lightering services that are provided to the Company's customers in the Delaware Bay region pursuant to contracts under which it commits to provide such services using a vessel of the Company's choice. When choosing the vessel, the Company takes into account vessel positioning and capacity at the time the inbound vessel is ready to discharge its cargo.

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**Consecutive Voyage Charters or CVC** CVC is the abbreviation for Consecutive Voyage Charter, which are used when a customer contracts for a particular vessel for a certain period of time to transport cargo between specified points for a rate that is determined based on the volume of cargo delivered. The Company bears the risk of delays under CVC arrangements.

**Crude Oil** Oil in its natural state that has not been refined or altered.

**Cubic Meters or cbm** cbm is the abbreviation for cubic meters, the industry standard for measuring the carrying capacity of a LNG Carrier.

**Deadweight tons or dwt** dwt is the abbreviation for deadweight tons, representing principally the cargo carrying capacity of a vessel, but including the weight of consumables such as fuel, lube oil, drinking water and stores.

**Demurrage** Additional revenue paid to the shipowner on its Voyage Charters for delays experienced in loading and/or unloading cargo, which are not deemed to be the responsibility of the shipowner, calculated in accordance with specific Charter terms.

**Double Hull** Hull construction design in which a vessel has an inner and an outer side and bottom separated by void space, usually two meters in width.

**Drydocking** An out-of-service period during which planned repairs and maintenance are carried out, including all underwater maintenance such as external hull painting. During the drydocking, certain mandatory Classification Society inspections are carried out and relevant certifications issued. Normally, as the age of a vessel increases, the cost of drydocking increases.

**Handysize Product Carrier** A small size Product Carrier of approximately 30,000 to 50,000 deadweight tons. This type of vessel generally operates on shorter routes (short haul).

**IMO** IMO is the abbreviation for International Maritime Organization, an agency of the United Nations, which is the body that is responsible for the administration of internationally developed maritime safety and pollution treaties, including MARPOL.

**International Flag vessel** A vessel that is registered under a flag other than that of the U.S.

**Jones Act** U.S. law that applies to port-to-port shipments within the continental U.S. and between the continental U.S. and Hawaii, Alaska, Puerto Rico, and Guam, and restricts such shipments to U.S. Flag Vessels that are built in the U.S. and that are owned by a U.S. company that is more than 75% owned and controlled by U.S. citizens.

**Lightering** The process of off-loading crude oil or petroleum products from deeply laden inbound tankers into smaller tankers and/or barges.

**LNG Carrier** A vessel designed to carry liquefied natural gas, that is, natural gas cooled to -163° centigrade, turning it into a liquid and reducing its volume to 1/600 of its volume in gaseous form. LNG is the abbreviation for liquefied natural gas.

**MARPOL** International Convention for the Prevention of Pollution from Ships, 1973, as modified by the Protocol of 1978 relating thereto. This convention includes regulations aimed at preventing and minimizing pollution from ships by accident and by routine operations.

**OPA 90** OPA 90 is the abbreviation for the U.S. Oil Pollution Act of 1990.

**Panamax** A medium size vessel of approximately 50,000 to 80,000 deadweight tons.

**Product Carrier** General term that applies to any tanker that is used to transport refined oil products, such as gasoline, jet fuel or heating oil.

**Pure Car Carrier** A single-purpose vessel with many decks, designed to carry automobiles, which are driven on and off using ramps.

**Scrapping** The disposal of vessels by demolition for scrap metal.

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**Special Survey** An extensive inspection of a vessel by classification society surveyors that must be completed within five years. Special Surveys require a vessel to be drydocked.

**Suezmax** A large crude oil tanker of approximately 120,000 to 200,000 deadweight tons. Modern Suezmaxes can generally transport about one million barrels of crude oil.

**Technical Management** The management of the operation of a vessel, including physically maintaining the vessel, maintaining necessary certifications, and supplying necessary stores, spares, and lubricating oils. Responsibilities also generally include selecting, engaging and training crew, and arranging necessary insurance coverage.

**Time Charter** A Charter under which a customer pays a fixed daily or monthly rate for a fixed period of time for use of the vessel. Subject to any restrictions in the Charter, the customer decides the type and quantity of cargo to be carried and the ports of loading and unloading. The customer pays all voyage expenses such as fuel, canal tolls, and port charges. The shipowner pays all vessel expenses such as the Technical Management expenses.

**Time Charter Equivalent or TCE** TCE is the abbreviation for Time Charter Equivalent. TCE revenues, which is voyage revenues less voyage expenses, serves as an industry standard for measuring and managing fleet revenue and comparing results between geographical regions and among competitors.

**U.S. Flag vessel** A U.S. Flag vessel must be crewed by U.S. sailors, and owned and operated by a U.S. company.

**Vessel Expenses** Includes crew costs, vessel stores and supplies, lubricating oils, maintenance and repairs, insurance and communication costs associated with the operations of vessels.

**VLCC** VLCC is the abbreviation for Very Large Crude Carrier, a large crude oil tanker of approximately 200,000 to 320,000 deadweight tons. Modern VLCCs can generally transport two million barrels or more of crude oil. These vessels are mainly used on the longest (long haul) routes from the Arabian Gulf to North America, Europe, and Asia, and from West Africa to the U.S. and Far Eastern destinations.

**Voyage Charter** A Charter under which a customer pays a transportation charge for the movement of a specific cargo between two or more specified ports. The shipowner pays all voyage expenses, and all vessel expenses, unless the vessel to which the Charter relates has been time chartered in. The customer is liable for Demurrage, if incurred.

**Voyage Expenses** Includes fuel, port charges, canal tolls, cargo handling operations and brokerage commissions paid by the Company under Voyage Charters. These expenses are subtracted from shipping revenues to calculate Time Charter Equivalent Revenues for Voyage Charters.

**V-Plus** A large crude oil tanker of more than 350,000 deadweight tons. Modern V Pluses can transport three million barrels of crude oil and are mainly used on the same long haul routes as VLCCs.

**Worldscale** Industry name for the Worldwide Tanker Nominal Freight Scale published annually by the Worldscale Association as a rate reference for shipping companies, brokers, and their customers engaged in the bulk shipping of oil in the international markets. Worldscale is a list of calculated rates for specific voyage itineraries for a standard vessel, as defined, using defined voyage cost assumptions such as vessel speed, fuel consumption and port costs. Actual market rates for voyage charters are usually quoted in terms of a percentage of Worldscale.

### **Available Information**

The Company makes available free of charge through its internet website, [www.osg.com](http://www.osg.com), its Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to these reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, as soon as reasonably practicable after the Company electronically files such material with, or furnishes it to, the Securities and Exchange Commission.

The Company also makes available on its website, its corporate governance guidelines, its code of business conduct, and charters of the Audit Committee, Compensation Committee and Corporate Governance and Nominating Committee of the Board of Directors.

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**ITEM 1A. RISK FACTORS**

The following important risk factors could cause actual results to differ materially from those contained in the forward-looking statements made in this report or presented elsewhere by management from time to time. If any of the circumstances or events described below actually arise or occur, the Company's business, results of operations and financial condition could be materially adversely affected.

*Industry specific risk factors:*

*The highly cyclical nature of the industry may lead to volatile changes in charter rates and vessel values, which may adversely affect the Company's earnings*

Factors affecting the supply and demand for vessels are outside of the Company's control, and the nature, timing and degree of changes in industry conditions are unpredictable and may adversely affect the values of the Company's vessels and result in significant fluctuations in the amount of charter hire the Company may earn, which could result in significant fluctuations in OSG's quarterly results. The factors that influence the demand for tanker capacity include:

demand for oil and oil products, which affect the need for vessel capacity;

global and regional economic and political conditions which among other things, could impact the supply of oil as well as trading patterns and the demand for various types of vessels;

changes in the production of crude oil, particularly by OPEC and other key producers, which impact the need for vessel capacity;

developments in international trade;

changes in seaborne and other transportation patterns, including changes in the distances that cargoes are transported;

environmental concerns and regulations;

new pipeline construction and expansions;

weather; and

competition from alternative sources of energy.

The factors that influence the supply of vessel capacity include:

the number of newbuilding deliveries;

the scrapping rate of older vessels;

the number of vessels that are out of service; and

environmental and maritime regulations.

*An increase in the supply of vessels without an increase in demand for such vessels could cause charter rates to decline, which could have a material adverse effect on OSG's revenues and profitability*

Historically, the marine transportation industry has been cyclical. The profitability and asset values of companies in the industry have fluctuated based on changes in the supply and demand of vessels. The supply of vessels generally increases with deliveries of new vessels and decreases with the scrapping of older vessels. The newbuilding order book equaled 36.6% of the existing world tanker fleet as of December 31, 2006 and no assurance can be given that the order book will not increase further in proportion to the existing fleet. If the number of new ships delivered exceeds the number of vessels being scrapped, capacity will increase. If supply increases and demand does not, the charter rates for the Company's vessels could decline significantly. A decline in charter rates could have a material



adverse effect on OSG's revenues and profitability.

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### *Charter rates may decline from their current level, which could have a material adverse effect on OSG's revenues and profitability*

Because many of the factors that influence the supply of, and demand for, tanker capacity are unpredictable and beyond the Company's control, the nature, timing and degree of changes in charter rates are unpredictable. A decline in charter rates could have a material adverse effect on OSG's revenues and profitability.

### *OSG's revenues are subject to seasonal variations*

OSG operates its tankers in markets that have historically exhibited seasonal variations in demand for tanker capacity, and therefore, charter rates. Charter rates for tankers are typically higher in the fall and winter months as a result of increased oil consumption in the Northern Hemisphere. Because a majority of the Company's vessels trade in the spot market, seasonality has affected OSG's operating results on a quarter-to-quarter basis and could continue to do so in the future.

### *Terrorist attacks and international hostilities can affect the tanker industry, which could adversely affect OSG's business*

Additional terrorist attacks like those in New York on September 11, 2001 and in London on July 7, 2005, the outbreak of war or the existence of international hostilities could damage the world economy, adversely affect the availability of and demand for crude oil and petroleum products and adversely affect the Company's ability to re-charter its vessels on the expiration or termination of the charters and the charter rates payable under any renewal or replacement charters. The Company conducts its operations internationally, and its business, financial condition and results of operations may be adversely affected by changing economic, political and government conditions in the countries and regions where its vessels are employed. Moreover, OSG operates in a sector of the economy that is likely to be adversely impacted by the effects of political instability, terrorist or other attacks, war or international hostilities.

### *The market value of vessels fluctuates significantly, which could adversely affect OSG's liquidity, result in breaches of its financing agreements or otherwise adversely affect its financial condition*

The market value of vessels has fluctuated over time. The fluctuation in market value of vessels over time is based upon various factors, including:

age of the vessel;

general economic and market conditions affecting the tanker industry;

number of vessels in the world fleet;

types and sizes of vessels available;

changes in trading patterns affecting demand for particular sizes and types of vessels;

cost of newbuildings;

prevailing level of charter rates;

competition from other shipping companies;

other modes of transportation; and

technological advances in vessel design and propulsion.

Declining values of the Company's vessels could adversely affect its liquidity by limiting its ability to raise cash by refinancing vessels. Declining vessel values could also result in a breach of loan covenants or trigger events of default under relevant financing agreements that require the Company to maintain certain loan-to-value ratios. In such instances, if OSG is unable to pledge additional collateral to offset the decline in vessel values, its lenders could accelerate its debt and foreclose on its vessels pledged as collateral for the loans.

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### *Shipping is a business with inherent risks, and OSG's insurance may not be adequate to cover its losses*

OSG's vessels and their cargoes are at risk of being damaged or lost because of events such as:

marine disasters;

bad weather;

mechanical failures;

human error;

war, terrorism and piracy; and

other unforeseen circumstances or events.

In addition, transporting crude oil creates a risk of business interruptions due to political circumstances in foreign countries, hostilities, labor strikes, port closings and boycotts. Any of these events may result in loss of revenues and increased costs.

The Company carries insurance to protect against most of the accident-related risks involved in the conduct of its business. OSG currently maintains one billion dollars in coverage for each of its vessels for liability for spillage or leakage of oil or pollution. OSG also carries insurance covering lost revenue resulting from vessel off-hire due to vessel damage. Nonetheless, risks may arise against which the Company is not adequately insured. For example, a catastrophic spill could exceed OSG's insurance coverage and have a material adverse effect on its operations. In addition, OSG may not be able to procure adequate insurance coverage at commercially reasonable rates in the future, and OSG cannot guarantee that any particular claim will be paid. In the past, new and stricter environmental regulations have led to higher costs for insurance covering environmental damage or pollution, and new regulations could lead to similar increases or even make this type of insurance unavailable. Furthermore, even if insurance coverage is adequate to cover the Company's losses, OSG may not be able to timely obtain a replacement ship in the event of a loss. OSG may also be subject to calls, or premiums, in amounts based not only on its own claim records but also the claim records of all other members of the P & I Associations through which OSG obtains insurance coverage for tort liability. OSG's payment of these calls could result in significant expenses which would reduce its profits or cause losses.

### *Because OSG conducts its business on a worldwide basis, OSG faces a number of significant risks that could result in losses or higher costs*

The Company's vessels operate all over the world, exposing it to many risks, including:

changing economic, political and social conditions in the countries where OSG does business or where its vessels are registered or flagged;

the imposition of increased environmental and safety regulations by international organizations, Classification Societies, flag states and port states;

the imposition of taxes by flag states, port states and jurisdictions in which OSG or its subsidiaries are incorporated or where its vessels operate;

currency fluctuations;

pandemics or epidemics which may result in a disruption of worldwide trade including quarantines of certain areas;

terrorism, piracy and war, including the possible outbreak of hostilities that could reduce or otherwise affect the movement of oil from the Middle East; and

expropriation of its vessels.

As a result of these risks, OSG may incur losses or higher costs, including those incurred as a result of the impairment of its assets or a curtailment of its operations.



*Compliance with environmental laws or regulations may adversely affect OSG's business*

The Company's operations are affected by extensive and changing international, national and local environmental protection laws, regulations, treaties, conventions and standards in force in international waters, the jurisdictional waters of the countries in which OSG's vessels operate, as well as the countries of its vessels' registration. Many of these requirements are designed to reduce the risk of oil spills and other pollution, and OSG's compliance with these requirements can be costly.

These requirements can affect the resale value or useful lives of the Company's vessels, require a reduction in carrying 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, OSG could incur material liabilities, including cleanup obligations, in the event that there is a release of petroleum or other hazardous substances from its vessels or otherwise in connection with its operations. OSG could also become subject to personal injury or property damage claims relating to the release of or exposure to hazardous materials associated with its current or historic operations. Violations of or liabilities under environmental requirements also can result in substantial penalties, fines and other sanctions, including in certain instances, seizure or detention of the Company's vessels.

OSG could incur significant costs, including cleanup costs, fines, penalties, third-party claims and natural resource damages, as the result of an oil spill or other liabilities under environmental laws. See "Item 3. Legal Proceedings" for a discussion of OSG's recent settlement of U.S. Government claims relating to its handling of waste oils and maintenance of books and records related thereto. The Company is subject to the oversight of several government agencies, including the U.S. Coast Guard, the Environmental Protection Agency and the Maritime Administration of the U.S. Department of Transportation. OPA 90 affects all vessel owners shipping oil or hazardous material to, from or within the United States. OPA 90 allows for potentially unlimited liability without regard to fault for owners, operators and bareboat charterers of vessels for oil pollution in U.S. waters. Similarly, the International Convention on Civil Liability for Oil Pollution Damage, 1969, as amended, which has been adopted by most countries outside of the United States, imposes liability for oil pollution in international waters. 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.

OPA 90 provides for the scheduled phase out of all non double hull vessels that carry oil in bulk in U.S. waters. IMO and the European Union also have adopted separate phase out schedules applicable to single hull vessels operating in international and EU waters. These regulations will reduce the demand for single hull vessels, force the remaining single hull vessels into less desirable trading routes, increase the number of ships trading in routes open to single hull vessels and could increase demands for further restrictions in the remaining jurisdictions that permit the operation of these vessels. As a result, single hull vessels are likely to be chartered less frequently and at lower rates.

In addition, in complying with OPA, IMO regulations, EU directives and other existing laws and regulations and those that may be adopted, shipowners may incur significant additional costs in meeting new maintenance and inspection requirements, in developing contingency arrangements for potential spills and in obtaining insurance coverage. Government regulation of vessels, particularly in the areas of safety and environmental requirements, can be expected to become more strict in the future and require the Company to incur significant capital expenditures on its vessels to keep them in compliance, or even to scrap or sell certain vessels altogether. As a result of accidents such as the November 2002 oil spill from the Prestige, a 26 year old single hull tanker unrelated to the Company, OSG believes that regulation of the shipping industry will continue to become more stringent and more expensive for the Company and its competitors. In recent years, the IMO and EU have both accelerated their existing non double hull phase out schedules in response to highly publicized oil spills and other shipping incidents involving companies unrelated to OSG. Future accidents can be expected in the industry, and such accidents or other events could be expected to result in the adoption of even stricter laws and regulations, which could limit the Company's operations or its ability to do business and which could have a material adverse effect on OSG's business and financial results.

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*The market value of OSG's vessels, which have recently been at or near historically high levels, may be depressed at a time and in the event that it sells a vessel*

Vessel values have generally experienced high volatility and values have recently been at or near historically high levels. The fair market value of the Company's vessels can be expected to fluctuate, depending on general economic and market conditions affecting the tanker industry and competition from other shipping companies, types and sizes of vessels and other modes of transportation. In addition, although OSG has a modern fleet, as vessels grow older, they generally decline in value. These factors will affect the value of the Company's vessels at the time of any vessel sale. If for any reason, OSG sells a vessel at a time when prices have fallen, the sale may be at less than the vessel's carrying amount on its financial statements, with the result that the Company would also incur a loss on the sale and a reduction in earnings and surplus.

*Company specific risk factors:*

*OSG's financial condition would be materially adversely affected if the shipping income of OSG's foreign subsidiaries becomes subject to current taxation in the U.S.*

As a result of changes made by the 2004 Act, the Company does not report in taxable income on a current basis the undistributed shipping income earned by its international flag vessels, which in recent years represented substantially all of the Company's pre-tax income. These changes in the 2004 Act were made to make U.S. controlled shipping companies competitive with foreign-controlled shipping companies, which are generally incorporated in jurisdictions in which they either do not pay income taxes or pay minimal income taxes.

The Congressional elections in 2006 resulted in Democratic majorities in both the House of Representatives and the Senate. The Democrats, in their platform for the 2006 elections, said that they would seek to "repeal tax giveaways that encourage companies to move jobs overseas." While the Company believes that the changes made in the 2004 Act with respect to foreign shipping income do not "move jobs overseas," and, in fact, have enabled the Company to expand its U.S. Flag fleet and create jobs in the U.S., Congress may decide to repeal the changes made in the 2004 Act with respect to taxation of foreign shipping income. Such a repeal would have a materially adverse affect on the Company's business and financial results.

*The Company's substantial debt could adversely affect its financial condition*

OSG has substantial debt and debt service requirements. At December 31, 2006, the Company's consolidated total debt, including capital lease obligations, was \$1.34 billion and its unused borrowing capacity under revolving credit facilities was \$1.24 billion.

The amount of the Company's debt could have important consequences. For example, it could:

- increase OSG's vulnerability to general adverse economic and industry conditions;
- limit OSG's ability to fund future capital expenditures, working capital and other general corporate requirements;
- require the Company to dedicate a substantial portion of its cash flow from operations to make interest and principal payments on its debt;
- limit OSG's flexibility in planning for, or reacting to, changes in its business and the shipping industry;
- place OSG at a competitive disadvantage compared with competitors that have less debt; and
- limit OSG's ability to borrow additional funds, even when necessary to maintain adequate liquidity.

*When OSG's credit facilities mature, it may not be able to refinance or replace them*

When OSG's indebtedness matures, the Company may need to refinance it and may not be able to do so on favorable terms or at all. If OSG is able to refinance maturing indebtedness, the terms of any refinancing or alternate credit arrangements may contain terms and covenants that restrict OSG's financial and operating flexibility.

***The Company is highly dependent upon volatile spot market charter rates***

OSG depends on spot charters for a significant portion of its revenues. In 2006, 2005 and 2004, OSG derived approximately 69%, 69% and 85%, respectively, of its TCE revenues in the spot market. Although chartering a significant portion of OSG's vessels on the spot market affords it greater opportunity to increase income from operations when rates rise, dependence on the spot market could result in earnings volatility. A significant decrease in OSG's spot market TCE revenues could adversely effect its profit or result in cash losses.

***OSG may not be able to renew time charters when they expire or enter into new time charters for newbuilds***

There can be no assurance that any of the Company's existing time charters will be renewed or that it will be successful in entering into new time charters on certain of the newbuilds that will be delivered to the Company or if renewed or entered into, that they will be at favorable rates. If, upon expiration of the existing time charters or delivery of newbuilds, OSG is unable to obtain time charters or voyage charters at desirable rates, the Company's profitability may be adversely affected.

***Termination or change in the nature of OSG's relationship with any of the pools in which it participates could adversely affect its business***

All of the Company's VLCCs participate in the Tankers International pool. All of OSG's Aframax participate in the Aframax International pool. Five of its Panamax participate directly in Panamax International. Participation in these pools enhances the financial performance of the Company's vessels as a result of the higher vessel utilization. Any participant in any of these pools has the right to withdraw upon notice in accordance with the relevant pool agreement. The Company cannot predict whether the pools in which its vessels operate will continue to exist in the future. In addition, the EU is in the process of substantially reforming the way it regulates traditional agreements for maritime services from an antitrust perspective. These changes may impose new restrictions on the way the pools are operated and may prohibit such pooling arrangements altogether. The termination of any of these pools, any significant restriction on pooling arrangements or the withdrawal of any participants could adversely affect the ability to commercially market the respective types of vessels in pools.

***OSG may not be able to grow its fleet***

One part of OSG's strategy is to continue to grow its fleet on an opportunistic basis. The Company's ability to grow its fleets will depend upon a number of factors, many of which the Company cannot control. These factors include OSG's ability to:

identify acquisition candidates and joint venture opportunities;

replace expiring charters-in at comparable rates;

identify suitable charter-in opportunities;

consummate acquisitions or joint ventures;

integrate any acquired vessels or businesses successfully with its existing operations;

hire and train qualified personnel; and

obtain required financing.

***OSG's strategy of growing its business in part through acquisitions is capital intensive, time consuming and subject to a number of inherent risks***

Part of OSG's business strategy is to opportunistically acquire complementary businesses or vessels such as the Company's acquisitions of Stelmar Shipping Ltd. in January 2005 and Maritrans Inc. in November 2006. If the Company fails to develop and integrate any acquired businesses or vessels effectively, its earnings may be adversely affected. In addition, the Company's management team will need to devote substantial time and attention to the integration of the acquired businesses or vessels, which could distract them from their other duties and responsibilities.

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### *Operating costs and capital expenses will increase as the Company's vessels age*

In general, capital expenditures and other costs necessary for maintaining a vessel in good operating condition increase as the age of the vessel increases. Accordingly, it is likely that the operating costs of OSG's older vessels will increase. In addition, changes in governmental regulations and compliance with Classification Society standards may require OSG to make additional expenditures for new equipment. In order to add such equipment, OSG may be required to take its vessels out of service. There can be no assurance that market conditions will justify such expenditures or enable OSG to operate its older vessels profitably during the remainder of their economic lives.

### *OSG's purchase of second hand vessels carries risks associated with the quality of those vessels*

OSG's expansion strategy includes the opportunistic acquisition of quality second hand vessels either directly or through corporate acquisitions. Second hand vessels typically do not carry warranties with respect to their condition, whereas warranties are generally available for newbuildings. While the Company generally inspects all second hand vessels prior to purchase, such inspections would normally not provide OSG with as much knowledge about vessel condition as the Company would possess if the vessels had been built for it.

### *Delays or cost overruns in building new vessels, the double-hulling of certain vessels or in the scheduled shipyard maintenance of the Company's vessels could adversely affect OSG's results of operations*

Building new vessels, rebuilding certain of the Company's existing single-hulled barges and scheduled shipyard maintenance of vessels may be subject to the risks of delay or cost overruns caused by one or more of the following:

unforeseen quality or engineering problems;

work stoppages;

weather interference;

unanticipated cost increases;

delays in receipt of necessary materials or equipment; and

inability to obtain the requisite permits, approvals or certifications from the U.S. Coast Guard or international foreign flag state authorities and the applicable classification society upon completion of work.

Significant delays and cost overruns could materially increase the Company's expected contract commitments, which would have an adverse effect on the Company's revenues, borrowing capacity and results of operations. Furthermore, delays would result in vessels being out-of-service for extended periods of time, and therefore not earning any revenue, which could have a material adverse effect on OSG's revenues, financial condition and results of operations.

### *The Company's business would be adversely affected if it failed to comply with the Jones Act provisions on coastwise trade, or if these provisions were repealed and if changes in international trade agreements were to occur*

The Company is subject to the Jones Act and other federal laws that restrict maritime transportation between points in the U.S. (known as marine cabotage services or coastwise trade) to vessels built and registered in the U.S. and owned and manned by U.S. citizens. The Company is responsible for monitoring the ownership of its common stock and other interests to insure compliance with the Jones Act. If the Company does not comply with these restrictions, it would be prohibited from operating its vessels in U.S. coastwise trade, and under certain circumstances would be deemed to have undertaken an unapproved foreign transfer, resulting in severe penalties, including permanent loss of U.S. coastwise trading rights for the Company's vessels, fines or forfeiture of the vessels.

Additionally, the Jones Act restrictions on the provision of maritime cabotage services are subject to exceptions under certain international trade agreements, including the General Agreement on Trade in Services and the North American Free Trade Agreement. If maritime cabotage services were included in the General Agreement on Trade in Services, the North American Free Trade Agreement or other international trade agreements, or if the restrictions contained in the Jones Act were otherwise repealed or altered, the transportation of maritime cargo between U.S. ports could be opened to international-flag or international-manufactured vessels. On two occasions during 2005, the U.S. Secretary of Homeland Security, at the direction of the President of the U.S., issued limited waivers of the Jones Act for the transportation of petroleum and petroleum products as a result of the extraordinary circumstances created by Hurricane



Katrina and Hurricane Rita on Gulf Coast refineries and petroleum product pipelines. During the past several years, interest groups have lobbied Congress to repeal the Jones Act to facilitate international flag competition for trades and cargoes currently reserved for U.S. Flag vessels under the Jones Act and cargo preference laws. The Company believes that continued efforts will be made to modify or repeal the Jones Act and cargo preference laws currently benefiting U.S. Flag vessels. Because international vessels may have lower construction costs, wage rates and operating costs, this could significantly increase competition in the coastwise trade, which could have a material adverse effect on the Company's business, results of operations and financial condition.

***In the highly competitive international market, OSG may not be able to effectively compete for charters with companies with greater resources***

The Company's vessels are employed in a highly competitive market. Competition arises from other vessel owners, including major oil companies, which may have substantially greater resources than OSG does. Competition for the transportation of crude oil and other petroleum products depends on price, location, size, age, condition, and the acceptability of the vessel operator to the charterer. The Company believes that because ownership of the world tanker fleet is highly fragmented, no single vessel owner is able to influence charter rates. To the extent OSG enters into new geographic regions or provide new services, it may not be able to compete profitably. New markets may involve competitive factors that differ from those of the Company's current markets, and the competitors in those markets may have greater financial strength and capital resources than OSG does.

***Trading and complementary hedging activities in Forward Freight Agreements ("FFAs") and related FFA options subject the Company to trading risks and the Company may suffer trading losses that reduce earnings***

Due to shipping market volatility, success in this industry requires constant adjustment of the balance between chartering out vessels for long periods of time and trading them on a spot basis. The Company seeks to manage and mitigate that risk through trading and complementary hedging activities in forward freight agreements, or FFAs, and related FFA options. However, there is no assurance that the Company will be able at all times to successfully protect itself from volatility in the shipping market. The Company may not successfully mitigate its risks, leaving it exposed to unprofitable contracts and may suffer trading losses that reduce earnings and surplus.

***The Company is subject to certain credit risks with respect to its counterparties on contracts and failure of such counterparties to meet their obligations could cause the Company to suffer losses on such contracts, decreasing revenues and earnings***

The Company charters its vessels to other parties, who pay the Company a daily rate of hire. The Company also enters into Contracts of Affreightment ("COAs") and Voyage Charters. As OSG increases the portion of its revenues from time charters, it increases its reliance on the ability of time charterers to pay charter hire, especially when spot market rates are less than previously agreed upon time charter rates. Historically, the Company has not experienced any material problem collecting charter hire. Additionally, the Company enters into FFAs. All of these contracts subject the Company to counterparty credit risk. As a result, the Company is subject to credit risks at various levels, including with charterers or cargo interests. If the counterparties fail to meet their obligations, the Company could suffer losses on such contracts which would decrease revenues and earnings.

***As the Company expands its business, it will need to improve its operations and financial systems, and recruit additional staff and crew; if it cannot improve these systems or recruit suitable employees, it may not effectively control its operations***

The Company's current operating and financial systems may not be adequate as it implements its plan to expand, and its attempts to improve these systems may be ineffective. If the Company is unable to operate its financial and operations systems effectively or to recruit suitable employees for its vessels and offices as it expands its operations, it may be unable to effectively control and manage substantially larger operations. Although it is impossible to predict what errors might occur as the result of inadequate controls, it is the case that it is harder to oversee a sizable operation and, accordingly, more likely that errors will occur as operations grow and that additional management infrastructure and systems will be required to attempt to avoid such errors.

***Compliance with the environmental compliance plan agreed to with the U.S. Department of Justice imposes a more rigorous standard on OSG's technical management of its vessels, which may adversely affect its business***

In connection with the comprehensive settlement of the investigation by the U.S. Department of Justice of the Company's handling of waste oils and maintenance of books and records relating thereto, the Company agreed to implement and fund an environmental compliance plan, which contains detailed rules, programs and procedures that the Company must follow to ensure full compliance with environmental laws and regulations. The Company has implemented these rules, programs and procedures and does not believe that they will adversely affect its ability to technically manage its vessels in a competitive manner. However, because the environmental compliance plan is a condition of the Company's probation, violations of certain of these rules and procedures, while not necessarily a violation of environmental laws and regulations, could result in sanctions and have an adverse affect on the Company's business.

***OSG's vessels call on ports located in countries that are subject to restrictions imposed by the U.S. government, which could negatively affect the trading price of the Company's common stock***

From time to time, vessels in OSG's fleet call on ports located in countries subject to sanctions and embargoes imposed by the U.S. government and countries identified by the U.S. government as state sponsors of terrorism, such as Syria and Iran. Although these sanctions and embargoes do not prevent OSG's vessels from making calls to ports in these countries, potential investors could view such port calls negatively, which could adversely affect the Company's reputation and the market for its common stock.

***OSG depends on its key personnel and may have difficulty attracting and retaining skilled employees***

OSG's success depends to a significant extent upon the abilities and efforts of its key personnel. The loss of the services of any of the Company's key personnel or its inability to attract and retain qualified personnel in the future could have a material adverse effect on OSG's business, financial condition and operating results. In addition, of the Company's 11 executive officers, eight have served in their current positions for less than two years as of December 31, 2006.

***The Company may face unexpected drydock costs for its vessels***

Vessels must be drydocked periodically. The cost of repairs and renewals required at each drydock are difficult to predict with certainty and can be substantial. The Company's insurance does not cover these costs. In addition, vessels may have to be drydocked in the event of accidents or other unforeseen damage. OSG's insurance may not cover all of these costs. Large drydocking expenses could significantly decrease the Company's profits.

***Maritime claimants could arrest OSG's vessels, which could interrupt its cash flow***

Crew members, suppliers of goods and services to a vessel, shippers of cargo and other parties may be entitled to a maritime lien against that vessel for unsatisfied debts, claims or damages. In many jurisdictions, a maritime lien holder may enforce its lien by arresting a vessel through foreclosure proceedings. The arrest or attachment of one or more of the Company's vessels could interrupt OSG's cash flow and require it to pay a significant amount of money to have the arrest lifted. In addition, in some jurisdictions, such as South Africa, under the "sister ship" theory of liability, a claimant may arrest both the vessel that is subject to the claimant's maritime lien and any "associated" vessel, which is any vessel owned or controlled by the same owner. Claimants could try to assert "sister ship" liability against one vessel in the Company's fleet for claims relating to another vessel in its fleet.

***Governments could requisition OSG's vessels during a period of war or emergency without adequate compensation***

A government could requisition one or more of OSG's vessels for title or for hire. Requisition for title occurs when a government takes control of a vessel and becomes her owner, while requisition for hire occurs when a government takes control of a vessel and effectively becomes her charterer at dictated charter rates. Generally, requisitions occur during periods of war or emergency, although governments may elect to requisition vessels in other circumstances. Although OSG would be entitled to compensation in the event of a requisition of one or more of its vessels, the amount and timing of payment would be uncertain. Government requisition of one or more of OSG's vessels may negatively impact its revenues.

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## ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

## ITEM 2. PROPERTIES

### Vessels:

At December 31, 2006, the Company owned or operated (including newbuilds) an aggregate of 137 vessels. See tables presented under Item 1. Additional information about the Company's fleet is set forth on the Company's website, [www.osg.com](http://www.osg.com).

## ITEM 3. LEGAL PROCEEDINGS

On December 19, 2006, the Company and the U.S. Department of Justice reached a comprehensive settlement regarding violations concerning the Company's handling of waste oils and maintenance of books and records relating thereto stemming from an investigation that began in 2003. Pursuant to the settlement agreement, the Company has agreed to plead guilty to a total of 33 counts. One count concerns the improper discharge of oil in 2002. The remaining counts concern record-keeping violations, including making false statements, obstruction and conspiracy related to such record-keeping violations. The Company also agreed to pay a fine in the amount of \$27.8 million and to pay \$9.2 million to designated environmental community service programs, all of which has been reserved in the Company's financial statements. In addition, as a result of the settlement with the U.S. Department of Justice, the Company agreed to an environmental compliance program, which is substantially the same as the Company's existing environmental management programs, which the Company must follow for a three year period beginning on the date of sentencing by the federal court in the District of Massachusetts. The settlement agreement is subject to acceptance by the federal courts in the District of Massachusetts and the Eastern District of Texas, both of which are scheduled in March 2007.

The Company is a party, as plaintiff or defendant, to various suits in the ordinary course of business for monetary relief arising principally from personal injuries, collision or other casualty and to claims arising under charter parties. All such personal injury, collision or other casualty claims against the Company are fully covered by insurance (subject to deductibles not material in amount). Each of the claims involves an amount which, in the opinion of management, is not material to the Company's financial position, results of operations and cash flows.

## ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

### Executive Officers of the Registrant

Name	Age	Position Held	Has Served as Such Since
Morten Arntzen	51	President and Chief Executive Officer	January 2004
Myles R. Itkin	59	Executive Vice President, Chief Financial Office	