

BP PRUDHOE BAY ROYALTY TRUST

Form 10-Q

August 09, 2006

**Table of Contents**

**SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549**

**FORM 10-Q**

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

**For the quarterly period ended June 30, 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 1-10243**

**BP PRUDHOE BAY ROYALTY TRUST**

(Exact Name of Registrant as Specified in Its Charter)

Delaware

13-6943724

(State or Other Jurisdiction of Incorporation or  
Organization)

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

The Bank of New York, 101 Barclay Street, New York,  
NY

10286

(Address of Principal Executive Offices)

(Zip Code)

Registrant's Telephone Number, Including Area Code: (212) 815-6908

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

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated filer

Accelerated filer

Non-accelerated filer

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

Yes  No

As of August 9, 2006, 21,400,000 Units of Beneficial Interest were outstanding.

**TABLE OF CONTENTS**

**PART I**

**FINANCIAL INFORMATION**

**Item 1. Financial Statements**

**BP Prudhoe Bay Royalty Trust**

**BP Prudhoe Bay Royalty Trust**

**BP Prudhoe Bay Royalty Trust**

**BP Prudhoe Bay Royalty Trust**

**Notes to Financial Statements (Unaudited)**

**(Prepared on a Modified Basis of Cash Receipts and Disbursements)**

**June 30, 2006**

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

**Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

**Item 4. Controls and Procedures.**

**PART II**

**OTHER INFORMATION**

**Item 1. Legal Proceedings.**

**Item 1A. Risk Factors**

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

**Item 3. Defaults Upon Senior Securities.**

**Item 4. Submission of Matters to a Vote of Security Holders.**

**Item 5. Other Information.**

**Item 6. Exhibits.**

**SIGNATURE**

**EX-31**

**EX-32**

---

**Table of Contents**

**PART I  
FINANCIAL INFORMATION**

**Item 1. Financial Statements**

---

**Table of Contents**

**BP Prudhoe Bay Royalty Trust**  
**Statement of Assets, Liabilities and Trust Corpus**  
**(Prepared on a modified basis of cash receipts and disbursements)**  
**(Unaudited)**  
**(In thousands, except unit data)**

|  | <b>June 30,<br/>2006</b> | <b>December<br/>31,<br/>2005</b> |
|--|--------------------------|----------------------------------|
| <b>Assets</b>  |                          |                                  |
| Royalty Interest, net (Notes 1, 2 and 3)   | \$ 9,038                 | \$ 10,043                        |
| Cash and cash equivalents (Note 2)   | 1,008                    | 1,011                            |
| <br>   |                          |                                  |
| Total Assets   | \$ 10,046                | \$ 11,054                        |
| <br>   |                          |                                  |
| <b>Liabilities and Trust Corpus</b>  |                          |                                  |
| Accrued expenses   | \$ 299                   | \$ 178                           |
| Trust Corpus (40,000,000 units of beneficial interest authorized, 21,400,000 units issued and outstanding) | 9,747                    | 10,876                           |
| <br>   |                          |                                  |
| Total Liabilities and Trust Corpus   | \$ 10,046                | \$ 11,054                        |

See accompanying notes to financial statements (unaudited).

2

---

**Table of Contents**

**BP Prudhoe Bay Royalty Trust**  
**Statements of Cash Earnings and Distributions**  
**(Prepared on a modified basis of cash receipts and disbursements)**  
**(Unaudited)**  
**(In thousands, except unit data)**

|                                     | <b>Three Months Ended</b> |             | <b>Six Months Ended</b> |             |
|-------------------------------------|---------------------------|-------------|-------------------------|-------------|
|                                     | <b>June 30,</b>           |             | <b>June 30,</b>         |             |
|                                     | <b>2006</b>               | <b>2005</b> | <b>2006</b>             | <b>2005</b> |
| Royalty revenues                    | \$ 47,539                 | \$ 33,413   | \$ 92,922               | \$ 66,610   |
| Interest income                     | 18                        | 9           | 32                      | 14          |
| Less: Trust administrative expenses | (296)                     | (367)       | (453)                   | (518)       |
| Cash earnings                       | \$ 47,261                 | \$ 33,055   | \$ 92,501               | \$ 66,106   |
| Cash distributions                  | \$ 47,258                 | \$ 33,060   | \$ 92,504               | \$ 66,111   |
| Cash distributions per unit         | \$ 2.2083                 | \$ 1.5449   | \$ 4.3226               | \$ 3.0893   |
| Units outstanding                   | 21,400,000                | 21,400,000  | 21,400,000              | 21,400,000  |

See accompanying notes to financial statements (unaudited).

**Table of Contents**

**BP Prudhoe Bay Royalty Trust**  
**Statements of Changes in Trust Corpus**  
**(Prepared on a modified basis of cash receipts and disbursements)**  
**(Unaudited)**  
**(In thousands)**

|   | <b>Three Months Ended</b> |             | <b>Six Months Ended</b> |             |
|---|---------------------------|-------------|-------------------------|-------------|
|   | <b>June 30,</b>           |             | <b>June 30,</b>         |             |
|   | <b>2006</b>               | <b>2005</b> | <b>2006</b>             | <b>2005</b> |
| Trust Corpus at beginning of period     | \$ 10,230                 | \$ 12,171   | \$ 10,876               | \$ 12,881   |
| Cash earnings                           | 47,261                    | 33,055      | 92,501                  | 66,106      |
| (Increase) decrease in accrued expenses | 17                        | (29)        | (121)                   | (237)       |
| Cash distributions                      | (47,258)                  | (33,060)    | (92,504)                | (66,111)    |
| Amortization of Royalty Interest        | (503)                     | (502)       | (1,005)                 | (1,004)     |
| <br>                                    |                           |             |                         |             |
| Trust Corpus at end of period           | \$ 9,747                  | \$ 11,635   | \$ 9,747                | \$ 11,635   |

See accompanying notes to financial statements (unaudited).

4

---

**Table of Contents**

**BP Prudhoe Bay Royalty Trust**  
**Notes to Financial Statements (Unaudited)**  
**(Prepared on a Modified Basis of Cash Receipts and Disbursements)**  
**June 30, 2006**

**(1) Formation of the Trust and Organization**

BP Prudhoe Bay Royalty Trust (the Trust), a grantor trust, was created as a Delaware business trust pursuant to a Trust Agreement dated February 28, 1989 among The Standard Oil Company (Standard Oil), BP Exploration (Alaska) Inc. (BP Alaska), The Bank of New York (the Trustee) and The Bank of New York (Delaware), as co-trustee (the Trust Agreement). Standard Oil and BP Alaska are indirect wholly-owned subsidiaries of BP p.l.c. (BP). On February 28, 1989, Standard Oil conveyed an overriding royalty interest (the Royalty Interest) to the Trust. The Trust was formed for the sole purpose of owning and administering the Royalty Interest. The Royalty Interest represents the right to receive, effective February 28, 1989, a per barrel royalty (the Per Barrel Royalty) of 16.4246% on the lesser of (a) the first 90,000 barrels of the average actual daily net production of oil and condensate per quarter or (b) the average actual daily net production of oil and condensate per quarter from BP Alaska's working interest as of February 28, 1989 in the Prudhoe Bay Field situated on the North Slope of Alaska. Trust Unit holders will remain subject at all times to the risk that production will be interrupted or discontinued or fall, on average, below 90,000 barrels per day in any quarter. BP has guaranteed the performance of BP Alaska of its payment obligations with respect to the Royalty Interest.

The trustees of the Trust are The Bank of New York, a New York corporation authorized to do a banking business, and The Bank of New York (Delaware), a Delaware banking corporation. The Bank of New York (Delaware) serves as co-trustee in order to satisfy certain requirements of the Delaware Trust Act. The Bank of New York alone is able to exercise the rights and powers granted to the Trustee in the Trust Agreement.

The Per Barrel Royalty in effect for any day is equal to the price of West Texas Intermediate crude oil (the WTI Price) for that day less scheduled Chargeable Costs (adjusted in certain situations for inflation) and Production Taxes (based on statutory rates then in existence).

The Trust is passive, with the Trustee having only such powers as are necessary for the collection and distribution of revenues, the payment of Trust liabilities, and the protection of the Royalty Interest. The Trustee, subject to certain conditions, is obligated to establish cash reserves and borrow funds to pay liabilities of the Trust when they become due. The Trustee may sell Trust properties only (a) as authorized by a vote of the Trust Unit Holders, (b) when necessary to provide for the payment of specific liabilities of the Trust then due (subject to certain conditions) or (c) upon termination of the Trust. Each Trust Unit issued and outstanding represents an equal undivided share of beneficial interest in the Trust. Royalty payments are received by the Trust and distributed to Trust Unit Holders, net of Trust expenses, in the month succeeding the end of each calendar quarter. The Trust will terminate upon the first to occur of the following events:



**Table of Contents**

**BP Prudhoe Bay Royalty Trust**  
**Notes to Financial Statements (Unaudited)**  
**(Prepared on a Modified Basis of Cash Receipts and Disbursements)**  
**June 30, 2006**

- a. On or prior to December 31, 2010: upon a vote of Trust Unit Holders of not less than 70% of the outstanding Trust Units.
- b. After December 31, 2010: (i) upon a vote of Trust Unit Holders of not less than 60% of the outstanding Trust Units, or (ii) at such time the net revenues from the Royalty Interest for two successive years commencing after 2010 are less than \$1,000,000 per year (unless the net revenues during such period are materially and adversely affected by certain events).

In order to ensure the Trust has the ability to pay future expenses, the Trust established a cash reserve account which the Trustee believes is sufficient to pay approximately one year's current and expected liabilities and expenses of the Trust.

**(2) Basis of Accounting**

The financial statements of the Trust are prepared on a modified cash basis and reflect the Trust's assets, liabilities, Corpus, earnings, and distributions, as follows:

- a. Revenues are recorded when received (generally within 15 days of the end of the preceding quarter) and distributions to Trust Unit Holders are recorded when paid.
- b. Trust expenses (which include accounting, engineering, legal, and other professional fees, trustees' fees, and out-of-pocket expenses) are recorded on an accrual basis.
- c. Cash reserves may be established by the Trustee for certain contingencies that would not be recorded under generally accepted accounting principles.
- d. Amortization of the Royalty Interest is calculated based on the units of production method. Such amortization is charged directly to the Trust Corpus, and does not affect cash earnings. The daily rate for amortization per net equivalent barrel of oil for the three months ended June 30, 2006 and 2005 was \$0.38 and \$0.37, respectively and for the six months ended June 30, 2006 and 2005 it was \$0.38 and \$0.37, respectively. The Trust evaluates impairment of the Royalty Interest by comparing the undiscounted cash flows expected to be realized from the Royalty Interest to the carrying value, pursuant to Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. If the expected future undiscounted cash flows are less than the carrying value, the Trust recognizes an impairment loss for the difference between the carrying value and the estimated fair value of the Royalty Interest.

While these statements differ from financial statements prepared in accordance with accounting principles generally accepted in the United States of America, the modified cash basis of reporting revenues and distributions is considered to be the most meaningful because quarterly distributions to the Trust Unit Holders are based on net cash receipts. The

**Table of Contents**

**BP Prudhoe Bay Royalty Trust**  
**Notes to Financial Statements (Unaudited)**  
**(Prepared on a Modified Basis of Cash Receipts and Disbursements)**  
**June 30, 2006**

accompanying modified cash basis financial statements contain all adjustments necessary to present fairly the assets, liabilities and Corpus of the Trust as of June 30, 2006 and 2005, and the modified cash earning and distributions and changes in Trust Corpus for the three-month and six-month periods ended June 30, 2006 and 2005. The adjustments are of a normal recurring nature and are, in the opinion of the Trustee, necessary to fairly present the results of operations.

As of June 30, 2006 and December 31, 2005, cash equivalents which represent the cash reserve consist of US treasury bills with an initial term of less than three months.

Estimates and assumptions are required to be made regarding assets, liabilities and changes in Trust Corpus resulting from operations when financial statements are prepared. Changes in the economic environment, financial markets and any other parameters used in determining these estimates could cause actual results to differ, and the differences could be material.

The financial statements should be read in conjunction with the financial statements and related notes in the Trust's Annual Report on Form 10-K for the fiscal year ended December 31, 2005. The cash earnings and distributions for the interim period presented are not necessarily indicative of the results to be expected for the full year.

**(3) Royalty Interest**

The Royalty Interest is comprised of the following at June 30, 2006 and December 31, 2005 (in thousands):

|                                 | <b>June 30,<br/>2006</b> | <b>December<br/>31,<br/>2005</b> |
|---------------------------------|--------------------------|----------------------------------|
| Royalty Interest (at inception) | \$ 535,000               | \$ 535,000                       |
| Less: Accumulated amortization  | (352,444)                | (351,439)                        |
| Impairment write-down           | (173,518)                | (173,518)                        |
| Balance, end of period          | \$ 9,038                 | \$ 10,043                        |

**(4) Income Taxes**

The Trust files its federal tax return as a grantor trust subject to the provisions of subpart E of Part I of Subchapter J of the Internal Revenue Code of 1986, as amended, rather than as an association taxable as a corporation. The Trust Unit Holders are treated as the owners of Trust income and Corpus, and the entire taxable income of the Trust will be reported by the Trust Unit Holders on their respective tax returns.

**Table of Contents**

**BP Prudhoe Bay Royalty Trust**  
**Notes to Financial Statements (Unaudited)**  
**(Prepared on a Modified Basis of Cash Receipts and Disbursements)**  
**June 30, 2006**

If the Trust were determined to be an association taxable as a corporation, it would be treated as an entity taxable as a corporation on the taxable income from the Royalty Interest, the Trust Unit Holders would be treated as shareholders, and distributions to Trust Unit Holders would not be deductible in computing the Trust's tax liability as an association.

**(5) Subsequent Event**

On August 7, 2006, BP announced that BP Alaska had commenced a shutdown of the Prudhoe Bay Field. The shutdown followed the discovery of unexpectedly severe corrosion and a small spill from an oil transit line in the Prudhoe Bay Field.

Based on the information available at the date of this report, the Trustee is unable to estimate the magnitude or duration of the effect that the shutdown of the Prudhoe Bay Field will have on the Trust's royalty revenues and its cash distributions. See Item 1A in Part II of this report for additional information.

**Table of Contents**

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

*Cautionary Statement*

This report contains forward looking statements (that is, statements anticipating future events or conditions and not statements of historical fact). Words such as anticipate, expect, believe, intend, plan or project, and should could, potentially, possibly or may, and other words that convey uncertainty of future events or outcomes are intended to identify forward-looking statements. Forward-looking statements in this report are subject to a number of risks and uncertainties beyond the control of the Trustee. These risks and uncertainties include such matters as future changes in oil prices, oil production levels, economic activity, domestic and international political events and developments, legislation and regulation, and certain changes in expenses of the Trust.

The actual results, performance and prospects of the Trust could differ materially from those expressed or implied by forward-looking statements. Descriptions of some of the risks that could affect the future performance of the Trust appear in Item 1A, Risk Factors, of the Trust's Annual Report on Form 10-K for the fiscal year ended December 31, 2005 (the Annual Report) and in Item 1A of Part II this report. There may be additional risks of which the Trustee is unaware or which are currently deemed immaterial.

In the light of these risks, uncertainties and assumptions, you should not rely unduly on any forward-looking statements. Forward-looking events and outcomes discussed in the Annual Report and in this report may not occur or may transpire differently. The Trustee undertakes no obligation to update forward-looking statements after the date of this report, except as required by law, and all such forward-looking statements in this report are qualified in their entirety by the preceding cautionary statements.

*Liquidity and Capital Resources*

The Trust is a passive entity, and the Trustee's activities are limited to collecting and distributing the revenues from the Royalty Interest and paying liabilities and expenses of the Trust. Generally, the Trust has no source of liquidity and no capital resources other than the revenue attributable to the Royalty Interest that it receives from time to time. See the discussion under THE ROYALTY INTEREST in Part I, Item 1 of the Annual Report for a description of the calculation of the Per Barrel Royalty, and the discussion under THE PRUDHOE BAY UNIT AND FIELD - Reserve Estimates and INDEPENDENT OIL AND GAS CONSULTANTS REPORT in Part I, Item 1 of the Annual Report for information concerning the estimated future net revenues of the Trust. However, the Trustee has a limited power to borrow, establish a cash reserve, or dispose of all or part of the Trust Estate, under limited circumstances pursuant to the terms of the Trust Agreement. See the discussion under THE TRUST in Part I, Item 1 of the Annual Report. In 1999, due to declines in oil prices during the fourth quarter of 1998 and the first quarter of 1999, which resulted in the Trust not receiving cash distributions for two quarters, the Trustee established a \$1,000,000 cash reserve to provide liquidity to the Trust during any future periods in which the Trust does not receive a distribution. The Trustee will draw funds from the cash reserve account during any quarter in which the quarterly distribution received by the Trust does

**Table of Contents**

not exceed the liabilities and expenses of the Trust, and will replenish the reserve from future quarterly distributions, if any. The Trustee anticipates that it will keep this cash reserve program in place until termination of the Trust. Amounts set aside for the cash reserve are invested by the Trustee in U.S. government or agency securities secured by the full faith and credit of the United States. Interest income received by the Trust from the investment of the reserve fund is added to the distributions received from BP Alaska and paid to the holders of Units on each Quarterly Record Date.

As discussed under **CERTAIN TAX CONSIDERATIONS** in Part I, Item 1 of the Annual Report, amounts received by the Trust as quarterly distributions are income to the holders of the Units, (as are any earnings on investment of the cash reserve) and must be reported by the holders of the Units, even if such amounts are used to repay borrowings or replenish the cash reserve and are not received by the holders of the Units.

*Results of Operations*

Relatively modest changes in oil prices significantly affect the Trust's revenues and results of operations. Crude oil prices are subject to significant changes in response to fluctuations in the domestic and world supply and demand and other market conditions as well as the world political situation as it affects OPEC and other producing countries. The effect of changing economic conditions on the demand and supply for energy throughout the world and future prices of oil cannot be accurately projected.

Royalty revenues are generally received on the fifteenth day of the month following the end of the calendar quarter in which the related Royalty Production occurred (the Quarterly Record Date). The Trustee, to the extent possible, pays all accrued expenses of the Trust on the Quarterly Record Date on which the revenues for the quarter are received. For the statement of cash earnings and distributions, revenues and Trust expenses are recorded on a modified cash basis and, as a result, royalties paid to the Trust and distributions to Unit holders in the quarters ended June 30, 2006 and 2005, respectively, are attributable to BP Alaska's operations during the quarters ended March 31, 2006 and 2005, respectively.

The following table show the factors which were employed to compute the Per Barrel Royalty payments received by the Trust during the first two quarters of 2006 and 2005 (see Note 1 of Notes to Financial Statements in Part I, Item 1). The information in the table has been furnished by BP Alaska.

|                          | <b>Average<br/>WTI<br/>Price</b> | <b>Chargeable<br/>Costs</b> | <b>Cost<br/>Adjustment<br/>Factor</b> | <b>Adjusted<br/>Chargeable<br/>Costs</b> | <b>Production<br/>Taxes</b> | <b>Per Barrel<br/>Royalty</b> |
|--------------------------|----------------------------------|-----------------------------|---------------------------------------|--|-----------------------------|-------------------------------|
| <b>Calendar 2006</b>     |                                  |                             |                                       |  |                             |                               |
| 4 <sup>th</sup> Qtr 2005 | \$ 60.01                         | \$ 12.25                    | 1.521                                 | \$ 18.63                                 | \$ 8.01                     | \$ 33.37                      |
| 1 <sup>st</sup> Qtr 2006 | \$ 63.36                         | \$ 12.50                    | 1.530                                 | \$ 19.13                                 | \$ 8.50                     | 35.73                         |
| <b>Calendar 2005</b>     |                                  |                             |                                       |  |                             |                               |
| 4 <sup>th</sup> Qtr 2004 | 48.35                            | 12.00                       | 1.471                                 | 17.65                                    | 6.29                        | 24.41                         |
| 1 <sup>st</sup> Qtr 2005 | 49.70                            | 12.25                       | 1.477                                 | 18.09                                    | 6.49                        | 25.12                         |

**Table of Contents**

As long as BP Alaska's average daily net production from the Prudhoe Bay Unit exceeds 90,000 barrels, which BP Alaska currently projects will continue until the year 2012, the only factors affecting the Trust's revenues and distributions to Unit holders are changes in WTI Prices, scheduled annual increases in Chargeable Costs, changes in the Consumer Price Index, changes in Production Taxes and changes in the expenses of the Trust, contributions to the cash reserve and interest earned on the cash reserve. See, however, the Trust's Current Report on Form 8-K dated August 7, 2006 and Item 1A in Part II of this report for information concerning the recent shutdown of the Prudhoe Bay field. The shutdown is expected result in average daily net production from the Prudhoe Bay Unit falling below 90,000 barrels per day during the third quarter of 2006 and, possibly, during subsequent periods. Suspension or reduction of production from the Prudhoe Bay Unit is expected to have a material adverse effect on the Trust's results of operations for the fourth quarter of 2006 and any subsequent periods affected.

For more information concerning the calculation of the Per Barrel Royalty, see the discussion under "THE ROYALTY INTEREST" in Part I, Item 1 of the Annual Report.

*Quarter Ended June 30, 2006 Compared to  
Quarter Ended June 30, 2005*

As explained above, Trust royalty revenues received during the second quarter of the fiscal year are based on Royalty Production during the first quarter of the fiscal year. Royalty revenues received by the Trust in the quarter ended June 30, 2006 increased 42.3% from the revenues received in the corresponding quarter of 2005, due to a 27.5% period-to-period increase in the Average WTI Price from \$49.70 per barrel during the quarter ended March 31, 2005 to \$63.36 per Barrel during the quarter ended March 31, 2006. A 12.4% period-to-period increase in total deductible costs from \$24.58 per Barrel to \$27.63 per Barrel was due principally to a 31% increase in Production Taxes chargeable with respect to the quarter ended March 31, 2006, and partially offset the effect of the increase in the Average WTI Price on the Trust's revenues.

*Six Months Ended June 30, 2006 Compared to  
Six Months Ended June 30, 2005*

Trust royalty revenues increased 39.5% in the six months ended June 30, 2006 over the corresponding period in 2005, reflecting the cumulative effect of increases in revenues received during the last quarter of 2005 and the first quarter of 2006 over revenues received during the corresponding periods of 2004 and 2005. The revenue increase resulted from continued increases in Average WTI Prices during recent periods, which averaged \$61.69 per Barrel during the six months ended March 31, 2006 compared to an average of \$49.03 per Barrel during the six months ended March 31, 2005. An 11.9% increase in average total deductible costs charged during the two quarters ended March 31, 2005 over the corresponding average deductible costs during the two quarters ended March 31, 2005, due principally to increases in Production Taxes, partially offset the effect of the increases in the Average WTI Prices per Barrel on the Trust's revenues.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

The Trust is a passive entity and except for the Trust's ability to borrow money as necessary to pay liabilities of the Trust that cannot be paid out of cash on hand, the Trust is prohibited from

**Table of Contents**

engaging in borrowing transactions. The Trust periodically holds short-term investments acquired with funds held by the Trust pending distribution to Unit holders and funds held in reserve for the payment of Trust expenses and liabilities. Because of the short-term nature of these investments and limitations on the types of investments which may be held by the Trust, the Trust is not subject to any material interest rate risk. The Trust does not engage in transactions in foreign currencies which could expose the Trust or Unit holders to any foreign currency related market risk or invest in derivative financial instruments. It has no foreign operations and holds no long-term debt instruments.

**Item 4. Controls and Procedures.**

*Disclosure Controls and Procedures*

The Trustee has disclosure controls and procedures (as defined in Rule 13a-15(e) and Rule 15d-15(e) under the Exchange Act) that are designed to ensure that information required to be disclosed by the Trust in the reports that it files or submits under the Securities Exchange Act of 1934, as amended (the Exchange Act ) is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. These controls and procedures include but are not limited to controls and procedures designed to ensure that information required to be disclosed by the Trust in the reports that it files or submits under the Exchange Act is accumulated and communicated to the responsible trust officers of the Trustee to allow timely decisions regarding required disclosure.

Under the terms of the Trust Agreement and the Conveyance, BP Alaska has significant disclosure and reporting obligations to the Trust. BP Alaska is required to provide the Trust such information concerning the Royalty Interest as the Trustee may need and to which BP Alaska has access to permit the Trust to comply with any reporting or disclosure obligations of the Trust pursuant to applicable law and the requirements of any stock exchange on which the Units are issued. These reporting obligations include furnishing the Trust a report by February 28 of each year containing all information of a nature, of a standard and in a form consistent with the requirements of the SEC respecting the inclusion of reserve and reserve valuation information in filings under the Exchange Act and with applicable accounting rules. The report is required to set forth, among other things, BP Alaska's estimates of future net cash flows from proved reserves attributable to the Royalty Interest, the discounted present value of such proved reserves, the assumptions utilized in arriving at the estimates contained in the report, and the estimate of the quantities of proved reserves (including reductions of proved reserves as a result of modification of BP Alaska's estimates of proved reserves from prior years) added during the preceding year to the total proved reserves allocated to the BP Working Interests as of December 31, 1987. (See THE ROYALTY INTEREST Chargeable Costs in Part I, Item 1 of the Annual Report.)

In addition, the Conveyance gives the Trust and its independent accountants certain rights to inspect the books and records of BP Alaska and discuss the affairs, finances and accounts of BP Alaska relating to the BP Working Interests with representatives of BP Alaska; it also requires BP Alaska to provide the Trust with such other information as the Trustee may reasonably request from time to time and to which BP Alaska has access.

The Trustee's disclosure controls and procedures include ensuring that the Trust receives the information and reports that BP Alaska is required to furnish to the Trust on a timely basis, that

**Table of Contents**

the appropriate responsible personnel of the Trustee examine such information and reports, and that information requested from and provided by BP Alaska is included in the reports that the Trust files or submits under the Exchange Act.

As of the end of the period covered by this report, the trust officers of the Trustee responsible for the administration of the Trust conducted an evaluation of the Trust's disclosure controls and procedures. Their evaluation considered, among other things, that the Trust Agreement and the Conveyance impose enforceable legal obligations on BP Alaska, and that BP Alaska has provided the information required by those agreements and other information requested by the Trustee from time to time on a timely basis. The officers concluded that the Trust's disclosure controls and procedures are effective.

*Internal Control Over Financial Reporting*

There has not been any change in the Trust's internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Rule 13a-15 or Rule 15d-15 under the Exchange Act that occurred during the Trust's last fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Trust's internal control over financial reporting.



**Table of Contents**

**PART II  
OTHER INFORMATION**

**Item 1. Legal Proceedings.**

None.

**Item 1A. Risk Factors**

1. The following paragraphs supplement a risk factor described Part II, Item 1A in the Trust's Quarterly Report on Form 10-Q for the quarter ended March 31, 2006 which appears under the heading: *Bills pending in the Alaska Legislature to repeal Alaska's current oil production tax and provide for a new basis of taxation on the production of oil may result in higher production tax deductions from royalty payments to the Trust.*

On June 26, 2006, the Governor of Alaska called the Legislature into a third special session to continue consideration of his petroleum production tax bill, among other business. On August 6, 2006, the House passed a revised version of a new bill (CSHB 3001(FIN)), which introduces an investment based tax rate. Producers would be taxed on the production tax value of taxable oil (gross value at the point of production for the calendar year less the producer's lease expenditures for the year) at a rate varying from 20% for producers with a high investment factor (the quotient of the producer's total qualified capital expenditures incurred during the calendar year divided by the total amount of taxable and nontaxable oil and gas, in BTU equivalent barrels, produced from leases or properties in Alaska during the year) to 25% for producers with a low investment factor. The bill's proponents estimate that if companies maintain their current investments in Alaska, the tax rate would be approximately 22.5%.

The new bill was sent to the Senate on August 7, 2006. The third special session is required adjourn on August 10, 2006. At the date of this report, the Senate had taken no action on the bill.

2. The following paragraphs supplement the risk factors described in Part I, Item 1A of the Annual Report and in Part II, Item 1A of the Trust's Quarterly Report on Form 10-Q for the quarter ended March 31, 2006:

***The shutdown of the Prudhoe Bay oil field may result in materially reduced distributions or no quarterly distributions to Unitholders for an indefinite period.***

On August 7, 2006, BP announced that BP Alaska had commenced a shutdown of the Prudhoe Bay field. The shutdown followed the discovery of unexpectedly severe corrosion and a small spill from an oil transit line in the Prudhoe Bay field. For additional information, see the Trust's Current Report on Form 8-K dated August 7, 2006.

Based on the information available at the date of this report, the Trustee is unable to estimate the magnitude or duration of the effect that the shutdown of the Prudhoe Bay oil

**Table of Contents**

field will have on the Trust's royalty revenues and its cash distributions. The magnitude of the effect on the Trust's revenues and distributions will depend on whether the Prudhoe Bay field is shut down completely and, if the field is completely shut down, when production from the field, or parts of the field, resumes. To the extent that the shutdown of the Prudhoe Bay field results in the average daily net production of oil and condensate from the BP Working Interests falling below 90,000 barrels per day during the current quarter ending September 30, 2006 and any subsequent quarter, the Trustee anticipates that there will be an adverse effect on the royalty revenues receivable by the Trust, and a decrease, which may be material, in funds available for distribution to Unit holders with respect to those periods. If the Prudhoe Bay field should be completely shut down during the entire fourth quarter of 2006 and any subsequent quarter, the Trust would receive no revenues with respect to those periods.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

None.

**Item 3. Defaults Upon Senior Securities.**

None.

**Item 4. Submission of Matters to a Vote of Security Holders.**

None.

**Item 5. Other Information.**

(a) In July 2006 the Trust received a cash distribution of \$55,796,947 from BP Alaska with respect to the quarter ended June 30, 2006. On July 20, 2006, after adding interest income received from investment of the cash reserve and deducting Trust administrative expenses, the Trustee distributed \$55,538,026 (approximately \$2.60 per Unit) to Unit holders of record on July 17, 2006 (Form 8-K, Item 8.01).

(b) Not applicable.

**Item 6. Exhibits.**

- 4.1 BP Prudhoe Bay Royalty Trust Agreement dated February 28, 1989 among The Standard Oil Company, BP Exploration (Alaska) Inc., The Bank of New York, Trustee, and F. James Hutchinson, Co-Trustee.
- 4.2 Overriding Royalty Conveyance dated February 27, 1989 between BP Exploration (Alaska) Inc. and The Standard Oil Company.
- 4.3 Trust Conveyance dated February 28, 1989 between The Standard Oil Company and BP Prudhoe Bay Royalty Trust.
- 4.4 Support Agreement dated as of February 28, 1989 among The British Petroleum Company p.l.c., BP Exploration (Alaska) Inc., The Standard Oil Company and BP Prudhoe Bay Royalty Trust.

**Table of Contents**

31 Rule 13a-14(a)/15d-14(a) Certification.

32 Section 1350 Certification.

**Table of Contents**

**SIGNATURE**

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

BP PRUDHOE BAY ROYALTY TRUST

By: THE BANK OF NEW YORK,  
as Trustee

By: /s/ Ming J. Ryan  
Ming J. Ryan  
Vice President

Date: August 9, 2006

The registrant is a trust and has no officers or persons performing similar functions. No additional signatures are available and none have been provided.

**Table of Contents**

**INDEX TO EXHIBITS**

| <b>Exhibit<br/>No.</b> | <b>Exhibit<br/>Description</b>   |
|------------------------|--|
| *4.1                   | BP Prudhoe Bay Royalty Trust Agreement dated February 28, 1989 among The Standard Oil Company, BP Exploration (Alaska) Inc., The Bank of New York, Trustee, and F. James Hutchinson, Co-Trustee. |
| *4.2                   | Overriding Royalty Conveyance dated February 27, 1989 between BP Exploration (Alaska) Inc. and The Standard Oil Company.   |
| *4.3                   | Trust Conveyance dated February 28, 1989 between The Standard Oil Company and BP Prudhoe Bay Royalty Trust.  |
| *4.4                   | Support Agreement dated as of February 28, 1989 among The British Petroleum Company p.l.c., BP Exploration (Alaska) Inc., The Standard Oil Company and BP Prudhoe Bay Royalty Trust.             |
| 31.                    | Rule 13a-14(a)/15d-14(a) Certification.  |
| 32                     | Section 1350 Certification.  |
| *                      | Incorporated by reference to the correspondingly numbered exhibit to the registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 1996 (Commission File No. 1-10243).      |