

BP PRUDHOE BAY ROYALTY TRUST

Form 10-K

March 16, 2006

Table of Contents

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934
For the Fiscal Year ended December 31, 2005**

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934
Commission File Number 1-10243
BP PRUDHOE BAY ROYALTY TRUST
(Exact name of registrant as specified in its charter)**

DELAWARE

State or other jurisdiction
of incorporation or organization)

13-6943724
(I.R.S. Employer Identification No.)

**THE BANK OF NEW YORK, TRUSTEE
101 BARCLAY STREET
NEW YORK, NEW YORK**

(Address of principal executive offices)

10286
(Zip Code)

Registrant's telephone number, including area code: (212) 815-6908
Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class

Name of Each Exchange on Which Registered

UNITS OF BENEFICIAL INTEREST

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 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.

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

The aggregate market value of Units held by nonaffiliates (computed by reference to the closing sale price in New York Stock Exchange transactions on June 30, 2005 (the last business day of the registrant's most recently completed second fiscal quarter) was approximately \$1,531,598,000.

As of March 16, 2006, 21,400,000 Units of Beneficial Interest were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

None

Table of Contents

TABLE OF CONTENTS

<u>PART I</u>	1
<u>ITEM 1. BUSINESS</u>	1
<u>INTRODUCTION</u>	1
<u>THE TRUST</u>	1
<u>THE ROYALTY INTEREST</u>	6
<u>THE UNITS</u>	8
<u>THE BP SUPPORT AGREEMENT</u>	10
<u>THE PRUDHOE BAY UNIT AND FIELD</u>	11
<u>INDEPENDENT OIL AND GAS CONSULTANTS' REPORT</u>	16
<u>INDUSTRY CONDITIONS AND REGULATIONS</u>	21
<u>CERTAIN TAX CONSIDERATIONS</u>	21
<u>ITEM 2. PROPERTIES</u>	23
<u>ITEM 1A. RISK FACTORS</u>	23
<u>ITEM 1B. UNRESOLVED STAFF COMMENTS</u>	26
<u>ITEM 3. LEGAL PROCEEDINGS</u>	26
<u>ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS</u>	26
<u>PART II</u>	26
<u>ITEM 5. MARKET FOR REGISTRANT'S UNITS, RELATED UNIT HOLDER MATTERS AND ISSUER PURCHASES OF UNITS</u>	26
<u>ITEM 6. SELECTED FINANCIAL DATA</u>	27
<u>ITEM 7. TRUSTEE'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	27
<u>ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	29
<u>ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA</u>	30
<u>ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE</u>	42
<u>ITEM 9A. CONTROLS AND PROCEDURES</u>	42
<u>ITEM 9B. OTHER INFORMATION</u>	44

Table of Contents

<u>PART III</u>	44
<u>ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT</u>	44
<u>ITEM 11. EXECUTIVE COMPENSATION</u>	45
<u>ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT</u>	45
<u>ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS</u>	45
<u>ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES</u>	46
<u>ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES</u>	46
<u>SIGNATURES</u>	48
<u>EX-31 Certification</u>	
<u>EX-32</u>	

Table of Contents

PART I

ITEM 1. BUSINESS

INTRODUCTION

BP Prudhoe Bay Royalty Trust (the Trust) was created as a Delaware business trust by the BP Prudhoe Bay Royalty Trust Agreement dated February 28, 1989 (the Trust Agreement) among The Standard Oil Company (Standard Oil), BP Exploration (Alaska) Inc. (BP Alaska), The Bank of New York, as trustee (the Trustee), and F. James Hutchinson, co-trustee (The Bank of New York (Delaware), successor co-trustee). BP Alaska and Standard Oil are wholly owned subsidiaries of BP p.l.c. (BP). The Trustee's corporate trust offices are located at 101 Barclay Street, New York, New York 10286 and its telephone number is (212) 815-6908.

The Trust electronically files annual reports on Form 10-K, quarterly reports on Form 10-Q and, when certain events require them, current reports on Form 8-K with the Securities and Exchange Commission (SEC). The public may read and copy any materials filed by the Trust with the SEC at the SEC's Public Reference Room at 450 Fifth Street, N.W., Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers (including the Trust) that file electronically with the SEC. The address of the SEC's web site is <http://www.sec.gov>.

The Trust does not have an Internet web site from which information concerning the Trust may be obtained; however the Trustee will provide paper or electronic copies of the Trust's reports on Form 10-K, Form 10-Q and Form 8-K, and amendments to those reports, free of charge upon request as soon as reasonably practicable after the Trust files them with the SEC. Requests for copies of reports may be made by mail to: The Bank of New York, 101 Barclay Street, New York, NY 10286, Attention: Mr. Remo Reale, Corporate Trust Department; by telephone to: (212) 815-6908; or by e-mail to: rreale@bankofny.com.

The information in this report relating to the Prudhoe Bay Unit, the calculation of royalty payments and certain other matters has been furnished to the Trustee by BP Alaska.

Forward-Looking Statements

Various sections of this report contain 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, should, would, 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 the following Item 1A, Risk Factors, and elsewhere in

Table of Contents

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 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.

THE TRUST

Trust Property

The property of the Trust consists of an overriding royalty interest (the Royalty Interest) and cash and cash equivalents held by the Trustee from time to time. The Royalty Interest entitles the Trust to a royalty on 16.4246 percent of the first 90,000 barrels* of the average actual daily net production of oil and condensate per quarter from the working interest of BP Alaska as of February 28, 1989 in the Prudhoe Bay oil field located on the North Slope in Alaska. The Prudhoe Bay field is one of four contiguous North Slope oil fields that are operated by BP Alaska and are known collectively as the Prudhoe Bay Unit. The Royalty Interest was conveyed to the Trust by an Overriding Royalty Conveyance dated February 27, 1989 from BP Alaska to Standard Oil and a Trust Conveyance dated February 28, 1989 from Standard Oil to the Trust. Copies of the Overriding Royalty Conveyance and the Trust Conveyance are filed with the SEC as exhibits to this report. The Overriding Royalty Conveyance and the Trust Conveyance are referred to collectively as the Conveyance.

The Royalty Interest is a non-operational interest in minerals. The Trust does not have the right to take oil and gas in kind, nor does it have any right to take over operations or to share in any operating decision with respect to BP Alaska's working interest in the Prudhoe Bay field. BP Alaska is not obligated to continue to operate any well or maintain or attempt to maintain in force any portion of its working interest when, in its reasonable and prudent business judgment, the well or interest ceases to produce or is not capable of producing oil or gas in paying quantities.

Employees

The Trust has no employees. All administrative functions of the Trust are performed by the Trustee.

Duties and Powers of the Trustee

The duties of the Trustee are specified in the Trust Agreement and the laws of the State of Delaware. The Bank of New York (Delaware) has been appointed co-trustee in order to satisfy certain requirements of the Delaware Trust Act, but The Bank of New York alone is able to exercise the rights and powers granted to the Trustee in the Trust Agreement. A copy of the Trust Agreement is filed as an exhibit to this report and is available upon request from the Trustee.

The basic function of the Trustee is to collect income from the Royalty Interest, to pay all expenses, charges and obligations of the Trust from the Trust's income and assets, and to pay available

* The term barrel is a unit of measure of petroleum liquids equal to 42 United States gallons corrected to 60 degrees Fahrenheit temperature.

Table of Contents

cash to Unit holders. Because of the passive nature of the Trust's assets and the restrictions on the power of the Trustee to incur obligations, the only liabilities incurred by the Trust are the Trustee's fees and routine administrative expenses, including accounting, legal and other professional fees.

The Trust Agreement grants the Trustee only the rights and powers necessary to achieve the purposes of the Trust. The Trust Agreement prohibits the Trust from engaging in any business or commercial activity or, with certain exceptions, any investment activity and from using any assets of the Trust to acquire any oil and gas lease, royalty or other mineral interest.

Except in certain circumstances, the Trustee is entitled to be indemnified out of the assets of the Trust for any liability or loss incurred by it in the performance of its duties unless the loss results from its negligence, bad faith or fraud or from expenses incurred in carrying out its duties that exceed the compensation and reimbursement to which it is entitled under the Trust Agreement.

Sales of Assets, Borrowings and Reserves

With certain exceptions, the Trustee may sell Trust assets only if authorized to do so by vote of the holders of 70 percent of the Units outstanding. However, if the sale is made in order to pay specific liabilities of the Trust then due and involves a part, but not all or substantially all, of the Trust properties, the sale only needs to be approved by the vote of holders of a majority of the Units. Any sale of Trust properties must be for cash unless otherwise authorized by the Unit holders. The Trustee is obligated to distribute the available net proceeds of any such sale to the Unit holders after establishing reserves for liabilities of the Trust.

The Trustee has the power to borrow on behalf of the Trust or to sell Trust assets to pay liabilities of the Trust and to establish a reserve for the payment of liabilities without the consent of the Unit holders under the following circumstances:

The Trustee may borrow from a lender not affiliated with the Trustee, if cash on hand is not sufficient to pay current liabilities, it is not practical to pay such liabilities out of funds anticipated to be available in a subsequent quarter, and failure to pay the liabilities would subject the Trust property to the risk of loss or diminution in value. To secure payment of its borrowings on behalf of the Trust, the Trustee is authorized to encumber the Trust's assets, and to carve out and convey production payments. The borrowing must be on terms which (in the opinion of an investment banking firm or commercial banking firm) are commercially reasonable when compared to other available alternatives. No distributions to Unit holders may be made until the borrowings by the Trust have been repaid in full.

If the Trustee is unable to borrow to pay Trust liabilities, the Trustee may sell Trust assets if it determines that the failure to pay the liabilities at a later date will be contrary to the best interest of the Unit holders and that it is not practicable to submit the sale to a vote of the Unit holders. The sale must be made for cash at a price which (in the opinion of an investment banking firm or commercial banking firm) is at least equal to the fair market value of the interest sold and is made on commercially reasonable terms when compared to other available alternatives.

The Trustee has the right to establish a cash reserve for the payment of material liabilities of the Trust which may become due if it determines that it is not practical to pay such liabilities out of funds anticipated to be available and that, in the absence of a reserve, the Trust

Table of Contents

property is subject to the risk of loss or diminution in value, or the Trustee is subject to the risk of personal liability for such liabilities.

In order for the Trustee to borrow, sell assets to pay Trust liabilities or establish a reserve for Trust liabilities, the Trustee must receive an unqualified written legal opinion that the action will not adversely affect the classification of the Trust as a grantor trust for federal income tax purposes or cause the income from the Trust to be treated as unrelated business taxable income for federal income tax purposes. If the Trustee is unable to obtain the required legal opinion, it still may proceed with the borrowing or sale, or establish the reserve, if it determines that the failure to do so will be materially detrimental to the Unit holders considered as a whole or will subject the Trustee to the risk of personal liability for liabilities of the Trust.

In 1999, 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 from BP Alaska. See Item 7 in Part II below.

Amendment of the Trust Agreement

The Trust Agreement may be amended without a vote of the Unit holders to cure an ambiguity, to correct or supplement any provision of the Trust Agreement that may be inconsistent with any other provision or to make any other provision with respect to matters arising under the Trust Agreement that do not adversely affect the Unit holders. The Trust Agreement may also be amended with the approval of holders of a majority of the outstanding Units. However, no such amendment may alter the relative rights of Unit holders, unless approved by the affirmative vote of holders of 100 percent of the outstanding Units and by the Trustee, or reduce or delay the distributions to the Unit holders or make certain other changes unless approved by the affirmative vote of holders of at least 80 percent of the outstanding Units and by the Trustee. No amendment will be effective until the Trustee has received a ruling from the Internal Revenue Service or an opinion of counsel to the effect that such modification will not adversely affect the classification of the Trust as a grantor trust for federal income tax purposes or cause the income from the Trust to be treated as unrelated business taxable income for federal income tax purposes.

Resignation or Removal of Trustee

The Trustee may resign at any time or be removed with or without cause by the holders of a majority of the outstanding Units. Its successor must be a corporation organized, doing business and authorized to exercise trust powers under the laws of the United States, any state thereof or the District of Columbia, or a national banking association domiciled in the United States, in either case having a combined capital, surplus and undivided profits of at least \$50,000,000 and subject to supervision or examination by federal or state authorities. Unless the Trust already has a trustee that is a resident of or has a principal office in Delaware, any successor trustee must be a resident of Delaware or have a principal office in Delaware. No resignation or removal of the Trustee will become effective until a successor trustee has accepted appointment.

Termination of the Trust

The Trust is irrevocable. BP Alaska has no power to terminate the Trust. The Trust will terminate: (a) on or before December 31, 2010 if holders of at least 70 percent of the outstanding Units vote to terminate the Trust, or (b) after December 31, 2010 either (i) holders at least 60 percent of the outstanding Units vote to terminate the Trust or (ii) the net revenues from the Royalty Interest for two

Table of Contents

successive years commencing after 2010 are less than \$1,000,000 per year (unless the net revenues during the two-year period have been materially and adversely affected by certain extraordinary events).

Upon termination of the Trust, BP Alaska will have an option to purchase the Royalty Interest at a price equal to the greater of (i) the fair market value of the Trust property as set forth in an opinion of an investment banking firm, commercial banking firm or other entity qualified to give an opinion as to the fair market value of the assets of the Trust, or (ii) the number of outstanding Units multiplied by (a) the closing price of Units on the day of termination of the Trust on the stock exchange on which the Units are listed, or (b) if the Units are not listed on any stock exchange but are traded in the over-the-counter market, the closing bid price on the day of termination of the Trust as quoted on the NASDAQ National Market System. The purchase must be for cash unless holders of 70 percent of the Units outstanding (60 percent if the decision to terminate the Trust is made after December 31, 2010) authorize the sale for non-cash consideration and the Trustee has received a ruling from the Internal Revenue Service or an opinion of counsel to the effect that such non-cash sale will not adversely affect the classification of the Trust as a grantor trust for federal income tax purposes or cause the income from the Trust to be treated as unrelated business taxable income for federal income tax purposes.

If BP Alaska does not exercise its option, the Trustee will sell the Trust properties on terms and conditions approved by the vote of holders of 70 percent of the outstanding Units (60 percent if the sale is made after December 31, 2010), unless the Trustee determines that it is not practicable to submit the matter to a vote of the Unit holders, and the sale is made at a price at least equal to the fair market value of the Trust property as set forth in the opinion mentioned above and on terms and conditions deemed commercially reasonable by the investment banking firm, commercial banking firm or other entity rendering the opinion.

The Trustee will distribute all available proceeds to the Unit holders after satisfying all existing liabilities of the Trust and establishing adequate reserves for the payment of contingent liabilities.

In the Trust Agreement, Unit holders have waived the right to seek or secure any portion or distribution of the Royalty Interest or any other asset of the Trust or any accounting during the term of the Trust or during any period of liquidation and winding up.

Voting Rights of Unit Holders

Unit holders possess certain voting rights, but their voting rights are not comparable to those of shareholders of a corporation. For example, there is no requirement for annual meetings of Unit holders or for periodic reelection of the Trustee.

A meeting of the Unit holders may be called at any time to act with respect to any matter as to which the Trust Agreement authorizes the Unit holders to act. Any such meeting may be called by the Trustee in its discretion and will be called (i) as soon as practicable after receipt of a written request by BP Alaska or a written request that sets forth in reasonable detail the action proposed to be taken at the meeting and is signed by holders of at least 25 percent of the outstanding Units or (ii) when required by applicable laws or regulations or the New York Stock Exchange. All meetings of Unit holders are required to be held in Manhattan, New York City.

Table of Contents

THE ROYALTY INTEREST

The Royalty Interest is a property right under Alaska law which burdens production, but there is no other security interest in the reserves or production revenues assigned to it. The royalty payable to the Trust for each calendar quarter is the sum of the amounts obtained by multiplying Royalty Production for each day in the calendar quarter by the Per Barrel Royalty for that day. The payment under the Royalty Interest for any calendar quarter may not be less than zero nor more than the aggregate value of the total production of oil and condensate from BP Alaska's working interest in the Prudhoe Bay Unit for the quarter, net of the State of Alaska royalty and less the value of any applicable payments made to affiliates of BP Alaska.

Royalty Production

The Royalty Production for each day in a calendar quarter is 16.4246 percent of the first 90,000 barrels of the actual average daily net production of oil and condensate for the quarter from the Prudhoe Bay (Permo-Triassic) Reservoir and allocated to the oil and gas leases owned by BP Alaska in the Prudhoe Bay Unit as of February 28, 1989 (the BP Working Interests). The Royalty Production is based on oil produced from the oil rim and condensate produced from the gas cap, but not on gas production or natural gas liquids production. The actual average daily net production of oil and condensate from the BP Working Interests for any calendar quarter is the total production of oil and condensate for the quarter, net of the State of Alaska royalty, divided by the number of days in the quarter.

Per Barrel Royalty

The Per Barrel Royalty for any day is the WTI Price for the day less the sum of (i) Chargeable Costs multiplied by the Cost Adjustment Factor and (ii) Production Taxes.

WTI Price

The WTI Price for any trading day is (i) the price (in dollars per barrel) for West Texas intermediate crude oil of standard quality having a specific gravity of 40 API degrees for delivery at Cushing, Oklahoma (West Texas Crude) quoted for that trading day by whichever of The Wall Street Journal, Reuters, or Platts Oilgram Price Report, in that order, publishes West Texas Crude price quotations for the trading day, or (ii) if the price of West Texas Crude is not published by one of those publications, the WTI Price will be the simple average of the daily mean prices (in dollars per barrel) quoted for West Texas Crude by one major oil company, one petroleum broker and one petroleum trading company designated by BP Alaska, in each case unaffiliated with BP and having substantial U.S. operations, until published price quotations are again available. If prices for West Texas Crude are not quoted so as to permit the calculation of the WTI Price, the price of West Texas Crude, for the purposes of calculating the WTI Price will be the price of another light sweet domestic crude oil of standard quality designated by BP Alaska and approved by the Trustee, with appropriate allowance for transportation costs to the Gulf coast (or another appropriate location) to equilibrate its price to the WTI Price. The WTI Price for any day which is not a trading day is the WTI Price for the preceding trading day.

Chargeable Costs

The Chargeable Costs per barrel of Royalty Production for each calendar year are fixed amounts specified in the Conveyance and do not necessarily represent BP Alaska's actual costs of

Table of Contents

production. Chargeable Costs per barrel were \$10.75 during 2001, \$11.25 during 2002, \$11.75 during 2003, \$12.00 during 2004, and \$12.25 during 2005. Chargeable Costs for 2006 and subsequent years are shown in the following table:

Calendar year	Chargeable Costs per barrel	Calendar year	Chargeable Costs per barrel
2006	\$ 12.50	2014	\$ 16.90
2007	12.75	2015	17.00
2008	13.00	2016	17.10
2009	13.25	2017	17.20
2010	14.50	2018	20.00
2011	16.60	2019	23.75
2012	16.70	2020	26.50
2013	16.80		

After 2020, Chargeable Costs increase at a uniform rate of \$2.75 per year.

Cost Adjustment Factor

The Cost Adjustment Factor for a quarter is the ratio of the Consumer Price Index published for the most recently past February, May, August or November to 121.1 (the Consumer Price Index for January 1989). The Consumer Price Index is the U.S. Consumer Price Index, all items and all urban consumers, U.S. city average (1982-84 equals 100), as first published, without seasonal adjustment, by the Bureau of Labor Statistics, Department of Labor, without regard to subsequent revisions or corrections. If the average WTI Price for any calendar quarter falls to \$18.00 or less, the Cost Adjustment Factor for that quarter will be the Cost Adjustment Factor for the immediately preceding quarter. If the average WTI Price returns to more than \$18.00 for a later quarter, adjustments to the Cost Adjustment Factor resume, but with an adjustment to the formula that excludes changes in the Consumer Price Index during the period that adjustments to the Cost Adjustment Factor were suspended.

Production Taxes

Production Taxes are the sum of any severance taxes, excise taxes (including windfall profit tax, if any), sales taxes, value added taxes or other similar or direct taxes imposed upon the reserves or production, delivery or sale of Royalty Production, computed at defined statutory rates. In the case of taxes based upon wellhead or field value, the Conveyance provides that the WTI Price less the product of \$4.50 and the Cost Adjustment factor will be deemed to be the wellhead or field value. At the present time, the Production Taxes payable with respect to the Royalty Production are the Alaska Oil and Gas Properties Production Tax (Alaska Production Tax). For the purposes of the Royalty Interest, the Alaska Production Tax is computed without regard to the economic limit factor, if any, as the greater of the percentage of value amount (based on the statutory rate and the wellhead value as defined above) and the cents per barrel amount. As of the date of this report, the statutory rate for the purpose of calculating the percentage of value amount is 15 percent. In February 2006, the Governor of Alaska proposed legislation that would replace the Alaska Production Tax with a net profits tax on producers (see Item 1A below). A surcharge to the Alaska Production Tax increased Production Taxes by \$0.05 per barrel of net production in 1989. Due to the spill response fund having reached \$50 million in 1995, \$0.02 per barrel of the surcharge has been indefinitely suspended. If the balance of the spill response fund falls below \$50 million, the \$0.02 per barrel surcharge will be reinstated until the fund balance again reaches \$50 million. The remaining \$0.03 per barrel surcharge is not affected by the fund's balance and will continue to be imposed at all times.

Table of Contents**Per Barrel Royalty Calculations**

The following table shows how the above-described factors interacted during the past five years to produce the Per Barrel Royalty paid for the calendar quarters indicated.

	Average WTI Price	Chargeable Costs	Cost Adjustment Factor	Adjusted Chargeable Costs	Production Taxes	Per Barrel Royalty
2001:						
1 st Qtr	\$28.83	\$10.75	1.354	\$14.55	\$3.44	\$10.84
2 nd Qtr	27.92	10.75	1.368	14.71	3.29	9.92
3 rd Qtr	26.82	10.75	1.367	14.69	3.13	9.00
4 th Qtr	20.41	10.75	1.366	14.68	2.17	3.56
2002:						
1 st Qtr	21.67	11.25	1.369	15.40	2.36	3.91
2 nd Qtr	26.28	11.25	1.384	15.57	3.04	7.67
3 rd Qtr	28.33	11.25	1.391	15.65	3.34	9.34
4 th Qtr	28.25	11.25	1.396	15.70	3.33	9.22
2003:						
1 st Qtr	34.08	11.75	1.410	16.57	4.19	13.32
2 nd Qtr	29.07	11.75	1.413	16.60	3.44	9.03
3 rd Qtr	30.30	11.75	1.421	16.70	3.62	9.98
4 th Qtr	31.23	11.75	1.421	16.69	3.76	10.78
2004:						
1 st Qtr	35.18	12.00	1.434	17.20	4.34	13.64
2 nd Qtr	38.31	12.00	1.456	17.47	4.79	16.05
3 rd Qtr	43.78	12.00	1.459	17.51	5.61	20.66
4 th Qtr	48.35	12.00	1.471	17.65	6.29	24.41
2005:						
1 st Qtr	49.70	12.25	1.477	18.09	6.49	25.12
2 nd Qtr	53.09	12.25	1.497	18.34	6.98	27.77
3 rd Qtr	63.03	12.25	1.512	18.53	8.46	36.04
4 th Qtr	60.01	12.25	1.521	18.63	8.01	33.37

THE UNITS**Units**

Each Unit represents an equal undivided share of beneficial interest in the Trust. The Units do not represent an interest in or an obligation of BP Alaska, Standard Oil or any of their respective affiliates. Units are evidenced by transferable certificates issued by the Trustee. Each Unit entitles its holder to the same rights as the holder of any other Unit. The Trust has no other authorized or outstanding class of securities.

Table of Contents

Distributions of Income

BP Alaska makes quarterly payments to the Trust of the amounts due with respect to the Trust's Royalty Interest on the fifteenth day following the end of each calendar quarter or, if the fifteenth is not a business day, on the next succeeding business day (the Quarterly Record Date). The Trustee pays all expenses of the Trust for each quarter on the Quarterly Record Date to the extent possible, then distributes the excess, if any, of the cash received by the Trust over the Trust's expenses, net of any additions to or subtractions from the cash reserve established for the payments of estimated liabilities (the Quarterly Distribution), to the persons in whose names the Units were registered at the close of business on the Quarterly Record Date.

The Trust Agreement requires the Trustee to pay the Quarterly Distribution to Unit holders on the fifth day after the Trustee's receipt of the amount paid by BP Alaska. Cash balances held by the Trustee for distribution are required to be invested in United States government or agency obligations secured by the full faith and credit of the United States (Government Obligations) or, if Government Obligations that mature on the date of the distribution to Unit holders are not available, in repurchase agreements with banks having capital, surplus and undivided profits of \$100,000,000 or more (which may include The Bank of New York) secured by Government Obligations. If time does not permit the Trustee to invest collected funds in Government Obligations or repurchase agreements, the Trustee may invest funds overnight in a time deposit with a bank meeting the foregoing capital requirement (including The Bank of New York).

Reports to Unit Holders

After the end of each calendar year, the Trustee mails a report to the persons who held Units of record during the year containing information to enable them to make the calculations necessary for federal and Alaska income tax purposes, including the calculation of any depletion or other deduction which may be available to them for the calendar year. In addition, after the end of each calendar year the Trustee mails Unit holders an annual report containing a copy of this Form 10-K and certain other information required by the Trust Agreement.

Limited Liability of Unit Holders

The Trust Agreement provides that the Unit holders are, to the full extent permitted by Delaware law, entitled to the same limitation of personal liability extended to stockholders of private corporations for profit under Delaware law.

Possible Divestiture of Units

The Trust Agreement imposes no restrictions on nationality or other status of the persons eligible to hold Units. However, it provides that if at any time the Trust or the Trustee is named a party in any judicial or administrative proceeding seeking the cancellation or forfeiture of any property in which the Trust has an interest because of the nationality, or any other status, of any one or more Unit holders, the Trustee may require each holder whose nationality or other status is an issue in the proceeding to dispose of his Units to a party not of the nationality or other status at issue in the proceeding. If any holder fails to dispose of his Units within 30 days after receipt of notice from the Trustee to do so, the Trustee will

Table of Contents

redeem any Unit not so transferred within 90 days after the end of the 30-day period specified in the notice for a cash price per Unit equal to the fair market value of the Units. Units redeemed by the Trustee will be cancelled.

The Trustee may cause the Trust to borrow any amount required to redeem the Units. If the purchase of Units from an ineligible holder by the Trustee would result in a non-exempt prohibited transaction under the Employee Retirement Income Security Act of 1970, or under the Internal Revenue Code of 1986, the Units subject to the Trustee's right of redemption will be purchased by BP Alaska or a designee of BP Alaska.

Issuance of Additional Units

The Trust Agreement provides that BP Alaska or an affiliate from time to time may assign to the Trust additional royalty interests meeting certain conditions and, upon satisfaction of various other conditions, the Trust may issue up to an additional 18,600,000 Units. BP Alaska has not conveyed any additional royalty interests to the Trust, and the Trust has not issued any additional Units.

THE BP SUPPORT AGREEMENT

BP has agreed to provide financial support to BP Alaska in meeting its payment obligations to the Trust in a Support Agreement dated February 28, 1989 among BP, BP Alaska, Standard Oil and the Trust (the Support Agreement). Within 30 days after it receives notice, BP will ensure that BP Alaska can perform its payment obligations under the Trust Agreement and the Conveyance, including contributing to BP Alaska the funds necessary to make such payments. BP's obligations under the Support Agreement are unconditional and directly enforceable by Unit holders.

Neither BP nor BP Alaska may transfer or assign its rights or obligations under the Support Agreement without the prior written consent of the Trustee, except that BP can arrange for its obligations to be performed by any its affiliates so long as BP remains responsible for ensuring that its obligations are performed in a timely manner.

BP Alaska may sell or transfer all or part of its working interest in the Prudhoe Bay Unit, although such a transfer will not relieve BP of its responsibility to ensure that BP Alaska's payment obligations under the Conveyance are performed.

BP will be released from its obligation under the Support Agreement upon the sale or transfer of all or substantially all of BP Alaska's working interest in the Prudhoe Bay Unit if the transferee agrees in writing to assume and be bound by BP's obligation under the Support Agreement. The transferee's agreement to assume BP's obligations must be reasonably satisfactory to the Trustee and the transferee must be an entity having a rating of its unsecured, unsupported long term debt of at least A3 from Moody's Investors Service, Inc., a rating of at least A- from Standard & Poor's or an equivalent rating from at least one nationally-recognized statistical rating organization (after giving effect to the sale or transfer and the assumption of all of BP Alaska's obligations under the Conveyance and all of BP's obligations under the Support Agreement).

Table of Contents**THE PRUDHOE BAY UNIT AND FIELD****Prudhoe Bay Unit Operation and Ownership**

Since several oil companies besides BP Alaska hold acreage within the Prudhoe Bay field, as well as the contiguous Endicott, Lisburne and Pt. McIntyre fields, the Prudhoe Bay Unit was established to optimize field development. Other owners of these fields include affiliates of Exxon Mobil Corporation, ConocoPhillips, ChevronTexaco Corporation and Forest Oil Corporation. The Trust's Royalty Interest pertains only to production from the Prudhoe Bay field and does not include production from the Endicott, Lisburne and Pt. McIntyre fields.

The operations of BP Alaska and the other working interest owners in the Prudhoe Bay Unit are governed by an agreement dated April 1, 1977 among the State of Alaska and the working interest owners establishing the Prudhoe Bay Unit (the Prudhoe Bay Unit Agreement) and an agreement dated April 1, 1977 among the working interest owners governing Prudhoe Bay Unit operations (the Prudhoe Bay Unit Operating Agreement).

The Prudhoe Bay Unit Operating Agreement specifies the allocation of production and costs to the working interest owners. It also defines operator responsibilities and voting requirements and is unusual in its establishment of separate participating areas for the gas cap and oil rim. Since July 1, 2000, BP Alaska has been the sole operator of the Prudhoe Bay Unit.

The ownership of the Prudhoe Bay Unit by participating area as of December 31, 2005 is shown in the following table:

	Oil rim	Gas cap
BP Alaska	26.35%(a)	26.35%(b)
Exxon Mobil	36.40	36.40
ConocoPhillips	36.07	36.07
Others	1.18	1.18
Total	100.00%	100.00%

(a) The Trust's share of oil production is computed based on BP Alaska's ownership interest in the oil rim participating area of 50.68 percent as of February 28, 1989. Subsequent decreases in BP Alaska's participation in oil rim ownership do not affect calculation of Royalty

Production from the BP Working Interests and have not decreased the Trust's Royalty Interest.

- (b) The Trust's share of condensate production is computed based on BP Alaska's ownership interest in the gas cap participating area of 13.84 percent as of February 28, 1989. Subsequent increases in BP Alaska's gas cap ownership do not affect calculation of Royalty Production from the BP Working Interests and have not increased the Trust's Royalty Interest.

If BP Alaska fails to pay any costs and expenses chargeable to BP Alaska under the Prudhoe Bay Unit Operating Agreement and the production of oil and condensate is insufficient to pay such costs and expenses, the Royalty Interest is chargeable with a pro rata portion of such costs and expenses and is subject to the enforcement against it of liens granted to the operators of the Prudhoe Bay Unit. However, in the Conveyance BP Alaska agreed to pay all costs and expenses chargeable to it and to ensure that no such costs and expenses will be chargeable against the Royalty Interest. The Trust is not liable for any loss or liability incurred by BP Alaska or others attributable to BP Alaska's working interest in the

Table of Contents

Prudhoe Bay Unit or to the oil produced from it, and BP Alaska has agreed to indemnify the Trust and hold it harmless against any such impositions.

BP Alaska has the right to amend or terminate the Prudhoe Bay Unit Agreement, the Prudhoe Bay Unit Operating Agreement and any leases or conveyances with respect to its working interest in the exercise of its reasonable and prudent business judgment without liability to the Trust. BP Alaska also has the right to sell or assign all or any part of its working interest in the Prudhoe Bay Unit, so long as the sale or assignment is expressly made subject to the Royalty Interest and the terms and provisions of the Conveyance.

The Prudhoe Bay Field

The Prudhoe Bay field is located on the North Slope of Alaska, 250 miles north of the Arctic Circle and 650 miles north of Anchorage. The Prudhoe Bay field extends approximately 12 miles by 27 miles and contains nearly 150,000 productive acres. The Prudhoe Bay field, which was discovered in 1968 by BP and others, has been in production since 1977 and is the largest producing oil field in North America. As of December 31, 2005, approximately 10.8 billion barrels of oil and condensate had been produced from the Prudhoe Bay field. Development is well advanced, with approximately \$19 billion gross capital spent and a total of about 3,189 wells drilled.

Field Geology

The principal hydrocarbon accumulations at Prudhoe Bay are in the Ivishak sandstone of the Sadlerochit Group at a depth of approximately 8,700 feet below sea level. The Ivishak is overlain by four minor reservoirs of varying extent which are designated the Put River, Eileen, Sag River and Shublik (PESS) formations. Underlying the Sadlerochit Group are the oil-bearing Lisburne and Endicott formations. The net production allocated to the Royalty Interest pertains only to the Ivishak and PESS formations, collectively known as the Prudhoe Bay (Permo-Triassic) Reservoir, and does not pertain to the Lisburne and Endicott formations.

The Ivishak sandstone was deposited, commencing some 250 million years ago, during the Permian and Triassic geologic periods. The sediments in the Ivishak are composed of sandstone, conglomerate and shale which were deposited by a massive braided river and delta system that flowed from an ancient mountain system to the north. Oil was trapped in the Ivishak by a combination of structural and stratigraphic trapping mechanisms.

Gross reservoir thickness is 550 feet, with a maximum oil column thickness of 425 feet. The original oil column is bounded on the top by a gas-oil contact, originally at 8,575 feet below sea level across the main field, and on the bottom by an oil-water contact at approximately 9,000 feet below sea level. A layer of heavy oil and tar overlays the oil-water contact in the main field and has an average thickness of around 40 feet.

Oil Characteristics

The oil produced from the Prudhoe Bay (Permo-Triassic) Reservoir is a medium grade, low sulfur crude with an average specific gravity of 27 API degrees. The gas cap composition is such that, upon surfacing, a liquid hydrocarbon phase, known as condensate, is formed.

Table of Contents

The Royalty Interest is based upon oil produced from the oil rim and condensate produced from the gas cap, but not upon gas production (which is currently uneconomic) or natural gas liquids production stripped from gas produced.

Historical Production

Production from the Prudhoe Bay field began on June 19, 1977, with the completion of the Trans-Alaska Pipeline System. As of December 31, 2005 there were about 1,111 active producing oil wells, 33 gas reinjection wells, 82 water injection wells and 136 water and miscible gas injection wells in the Prudhoe Bay field. Production from the Prudhoe Bay field has declined over the past five years. The average well production rate was about 546 barrels of oil per day in 2001, 375 barrels per day in 2002, 350 barrels per day in 2003, 317 barrels per day in 2004 and 293 barrels per day in 2005.

BP Alaska's share of the hydrocarbon liquids production from the Prudhoe Bay field includes oil, condensate and natural gas liquids. Using the production allocation procedures from the Prudhoe Bay Unit Operating Agreement, the Prudhoe Bay field's total production and the net share of oil and condensate (net of State of Alaska royalty) allocated to the BP Working Interests have been as follows during the past five years:

Calendar year	Oil		Condensate	
	Total field	Net to BP Working Interests (thousand barrels per day)	Total field	Net to BP Working Interests
2001	324.9	144.1	131.2	15.9
2002	293.8	130.3	121.5	14.7
2003	273.2	121.2	113.8	13.8
2004	243.4	107.9	109.0	13.2
2005	228.9	101.5	96.4	11.7

Transportation of Prudhoe Bay Oil

Production from the Prudhoe Bay field is carried to Pump Station 1, the starting point for the Trans-Alaska Pipeline System, through two 34-inch diameter transit lines, one from each half of the Prudhoe Bay field. At Pump Station 1, Alyeska Pipeline Service Company, the pipeline operator, meters the oil and pumps it in the 48-inch diameter pipeline to Valdez, almost 800 miles (1,287 km) to the south, where it is either loaded onto marine tankers or stored temporarily. It takes the oil about seven days to make the trip. The pipeline has a capacity of approximately 1.4 million barrels of oil per day.

Reservoir Management

The Prudhoe Bay field is a complex, combination-drive reservoir, with widely varying reservoir properties. Reservoir management involves directing field activities and projects to maximize the economic value of reserves.

Several different oil recovery mechanisms are currently active in the Prudhoe Bay field, including pressure depletion, gravity drainage/gas cap expansion, water flooding and miscible gas flooding. Separate yet integrated reservoir management strategies have been developed for the areas affected by each of these recovery processes.

Table of Contents

Reserve Estimates

The net proved remaining reserves of oil and condensate associated with the BP Working Interests is approximately 1,043 million barrels as of December 31, 2005. This estimate of reserves is based upon various assumptions, including a reasonable estimate of the allocation of hydrocarbon liquids between oil and condensate according to the procedures of the Prudhoe Bay Unit Operating Agreement. Estimates of proved reserves are inherently imprecise and subjective and are revised over time as additional data become available. Such revisions often may be substantial. BP Alaska anticipates that net production from current proved reserves allocated to the BP Working Interests will exceed 90,000 barrels per day until the year 2012. The occurrence of major gas sales could accelerate the time at which BP Alaska's net production would fall below 90,000 barrels per day, due to the consequent decline in reservoir pressure. BP Alaska projects continued economic production after 2012 at a declining rate until the year 2065; however, for the economic conditions and production forecast as of December 31, 2005, it is estimated that royalty payments will cease following the year 2023.

BP Alaska's reserve estimates and production assumptions and projections are predicated upon a reasonable estimate of hydrocarbon allocation between oil and condensate. Oil and condensate are physically produced in a commingled stream of hydrocarbon liquids. The allocation of hydrocarbon liquids between the oil and condensate from the Prudhoe Bay field is a theoretical calculation performed in accordance with procedures specified in the Prudhoe Bay Unit Operating Agreement. Due to the differences in percentages between oil and condensate, the overall share of oil and condensate production allocated to the BP Working Interests will vary over time according to the proportions of hydrocarbon liquid being allocated as condensate or as oil. Under the terms of an Issues Resolution Agreement entered into by the Prudhoe Bay Unit owners in October 1990, the allocation procedures have been adjusted to generally allocate condensate in a manner which approximates the anticipated decline in the production of oil until an agreed original condensate reserve of 1,175 million barrels has been allocated to the working interest owners.

The reserves attributable to the Trust's Royalty Interest constitute only a part of the overall reserves allocated to the BP Working Interests. BP Alaska has estimated that the net remaining proved reserves attributable to the Trust as of December 31, 2005 were 85.3 million barrels of oil and condensate. Using procedures specified in Financial Accounting Standards Board Statement of Financial Standards No. 69, BP Alaska calculated that as of December 31, 2005 production of oil and condensate from the proved reserves allocated to the Trust's Royalty Interest will result in estimated future net revenues to the Trust of \$2,095.2 million, with a present value of \$1,209.7 million. BP Alaska's estimates of proved reserves and the estimated future net revenues from the Prudhoe Bay Unit have been reviewed by Miller and Lents, Ltd., independent oil and gas consultants, as set forth in their report following this section.

There is no precise method of forecasting the allocation of reserve volumes between BP Alaska and the Trust. The Royalty Interest is not a working interest and the Trust is not entitled to receive any specific volume of reserves from the Prudhoe Bay field. Rather, reserve volumes attributable to the Trust at any given date are estimated by allocating to the Trust its share of estimated future production from the Prudhoe Bay field based on WTI Prices and other economic parameters in effect on the date of the evaluation.

Table of Contents

The following table shows the net remaining proved reserves of oil and condensate allocated to the BP Working Interests, the net proved reserves allocated to the Trust, and the WTI Prices on the dates indicated:

December 31	Net Proved Reserves		WTI Price per barrel
	BP Working Interests (a)	Trust (b)	
	(million barrels)		
2001	961.7	43.2	\$19.78
2002	908.7	85.8	31.23
2003	858.7	77.9	32.55
2004	941.4	77.4	43.46
2005	1,043.0	85.3	61.04

(a) Includes proved undeveloped reserves of 112.5 million barrels at December 31, 2001; 5.5 million barrels at December 31, 2002; 139.9 million barrels at December 31, 2003; 115.4 million barrels at December 31, 2004; and 73.0 million barrels at December 31, 2005.