MESA ROYALTY TRUST/TX
Form 10-Q
November 09, 2009

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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly period ended September 30, 2009

o **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: 1-7884

MESA ROYALTY TRUST

(Exact Name of Registrant as Specified in its Charter)

Texas	**76-6284806**
(State or other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
The Bank of New York Mellon Trust Company, N.A., Trustee 919 Congress Avenue Austin, Texas	**78701**
(Address of Principal Executive Offices)	(Zip Code)

1-800-852-1422

(Registrant's Telephone Number, Including Area Code)

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 o No ý

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No ý

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer o	Accelerated filer ý	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

As of November 6, 2009-1,863,590 Units of Beneficial Interest were outstanding in Mesa Royalty Trust.

PART I FINANCIAL INFORMATION

Item 1. ***Financial Statements.***

MESA ROYALTY TRUST

STATEMENTS OF DISTRIBUTABLE INCOME

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	**2008**	**2009**	**2008**
Royalty income	$ 923,220	$ 4,535,119	$ 2,803,368	$ 10,896,240
Interest income		10,840	215	36,834
General and administrative expense	(60,619)	(35,801)	(153,723)	(96,075)
Distributable income	$ 862,601	$ 4,510,158	$ 2,649,860	$ 10,836,999
Distributable income per unit	$ .4629	$ 2.4201	$ 1.4219	$ 5.8151
Units outstanding	1,863,590	1,863,590	1,863,590	1,863,590

STATEMENTS OF ASSETS, LIABILITIES AND TRUST CORPUS

	September 30, 2009 (Unaudited)	December 31, 2008
ASSETS		
Cash and short-term investments	$ 862,601	$ 2,917,460
Interest receivable		14,035
Net overriding royalty interest in oil and gas properties	42,498,034	42,498,034
Accumulated amortization	(35,886,391)	(35,462,995)
Total assets	$ 7,474,244	$ 9,966,534
LIABILITIES AND TRUST CORPUS		
Distributions payable	$ 862,601	$ 2,931,495
Trust corpus (1,863,590 units of beneficial interest authorized and outstanding)	6,611,643	7,035,039
Total liabilities and trust corpus	$ 7,474,244	$ 9,966,534

(The accompanying notes are an integral part of these financial statements.)

MESA ROYALTY TRUST

STATEMENTS OF CHANGES IN TRUST CORPUS

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	**2008**	**2009**	**2008**
Trust corpus, beginning of period	$ 6,768,816	$ 7,403,895	7,035,039	$ 7,692,213
Distributable income	862,601	4,510,158	2,649,860	10,836,999
Distributions to unitholders	(862,601)	(4,510,158)	(2,649,860)	(10,836,999)
Amortization of net overriding royalty interest	(157,173)	(160,506)	(423,396)	(448,824)
Trust corpus, end of period	$ 6,611,643	$ 7,243,389	$ 6,611,643	$ 7,243,389

(The accompanying notes are an integral part of these financial statements.)

MESA ROYALTY TRUST

STATEMENTS OF DISTRIBUTABLE INCOME
(Unaudited)

Note 1 Trust Organization

The Mesa Royalty Trust (the "Trust") was created on November 1, 1979. On that date, Mesa Petroleum Co., predecessor to Mesa Limited Partnership ("MLP"), which was the predecessor to MESA Inc. conveyed to the Trust an overriding royalty interest (the "Royalty") equal to 90% of the Net Proceeds (as defined in the Conveyance and described below) attributable to the specified interests in properties conveyed by the assignor on that date (the "Subject Interests"). The Subject Interests consisted of interests in certain producing oil and gas properties located in the Hugoton field of Kansas, the San Juan Basin field of New Mexico and Colorado and the Yellow Creek field of Wyoming (the "Royalty Properties"). The Royalty is evidenced by counterparts of an Overriding Royalty Conveyance dated as of November 1, 1979 (the "Conveyance"). On April 30, 1991, MLP sold its interests in the Royalty Properties located in the San Juan Basin field to ConocoPhillips. ConocoPhillips sold most of its interests in the San Juan Basin Royalty Properties located in Colorado to MarkWest Energy Partners, Ltd. (effective January 1, 1993) and Red Willow Production Company (effective April 1, 1992). On October 26, 1994, MarkWest Energy Partners, Ltd. sold substantially all of its interest in the Colorado San Juan Basin Royalty Properties to BP Amoco Company ("BP"), a subsidiary of BP p.l.c. Until August 7, 1997, MESA Inc. operated the Hugoton Royalty Properties through Mesa Operating Co., a wholly owned subsidiary of MESA Inc. On August 7, 1997, MESA Inc. merged with and into Pioneer Natural Resources Company ("Pioneer"), formerly a wholly owned subsidiary of MESA Inc., and Parker & Parsley Petroleum Company merged with and into Pioneer Natural Resources USA, Inc. (successor to Mesa Operating Co.), a wholly owned subsidiary of Pioneer ("PNR") (collectively, the mergers are referred to herein as the "Merger"). Subsequent to the Merger, the Hugoton Royalty Properties have been operated by PNR. Substantially all of the San Juan Basin Royalty Properties located in New Mexico are operated by ConocoPhillips. Substantially all of the San Juan Basin Royalty Properties located in Colorado are operated by BP. As used in this report, PNR refers to the operator of the Hugoton Royalty Properties, ConocoPhillips refers to the operator of the San Juan Basin Royalty Properties, other than the portion of such properties located in Colorado, and BP refers to the operator of the Colorado San Juan Basin Royalty Properties unless otherwise indicated.

Effective October 2, 2006, the Bank of New York Mellon Trust Company, N.A. (the "Trustee") succeeded JPMorgan Chase Bank, N.A. as Trustee of the Trust. JPMorgan Chase Bank, N.A. is the successor by mergers to the original name of the Trustee, Texas Commerce Bank National Association. The terms of the Mesa Royalty Trust Indenture (the "Trust Indenture") provide, among other things, that:

(a) the Trust cannot engage in any business or investment activity or purchase any assets;

(b) the Royalty can be sold in part or in total for cash upon approval by the unitholders;

(c) the Trustee can establish cash reserves and borrow funds to pay liabilities of the Trust and can pledge assets of the Trust to secure payment of the borrowings;

(d) the Trustee will make cash distributions to the unitholders in January, April, July and October each year as discussed more fully in Note 2;

(e) the Trust will terminate upon the first to occur of the following events: (i) at such time as the Trust's royalty income for two successive years is less than $250,000 per year or (ii) a vote by the unitholders in favor of termination. Upon termination of the Trust, the Trustee will sell for cash all the assets held in the Trust estate and make a final distribution to unitholders of any funds remaining after all Trust liabilities have been satisfied; and

(f) PNR, ConocoPhillips and BP (collectively the "Working Interest Owners") will reimburse the Trust for 59.34%, 27.45% and 1.77%, respectively, for general and administrative expenses of the Trust.

Note 2 Basis of Presentation

The accompanying unaudited financial information has been prepared by the Trustee in accordance with the instructions to Form 10-Q. The preparation of the financial statements requires estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates. The Trustee believes such information includes all the disclosures necessary to make the information presented not misleading. The information furnished reflects all adjustments which are, in the opinion of the Trustee, necessary for a fair presentation of the results for the interim periods presented. The financial information should be read in conjunction with the financial statements and notes thereto included in the Trust's Annual Report on Form 10-K for the year ended December 31, 2008. Subsequent events have been evaluated through November 9, 2009, the date of the issuance of these financial statements.

In accordance with the instruments conveying the Royalty, the Working Interest Owners will calculate and pay the Trust each month an amount equal to 90% of the Net Proceeds (as defined in the Conveyance) attributable to the month. In 1985, the Trust Indenture was amended and the Trust conveyed to an affiliate of Mesa Petroleum Co. 88.5571% of the original Royalty (such transfer, the "1985 Assignment"). The effect of the 1985 Assignment was an overall reduction of approximately 88.56% in the size of the Trust. As a result, the Trust is now entitled to receive 11.44% of 90% of the Net Proceeds attributable to each month.

Amortization of the Royalty is computed on a unit-of-production basis and is charged directly to trust corpus since such amount does not affect distributable income.

The financial statements of the Trust are prepared on the following basis:

(a) Royalty income recorded for a month is the amount computed and paid by the Working Interest Owners to the Trustee for such month rather than either the value of a portion of the oil and gas produced by the Working Interest Owners for such month or the amount subsequently determined to be the Trust's proportionate share of the net proceeds for such month;

(b) Interest income, interest receivable and distributions payable to unitholders include interest to be earned on short-term investments from the financial statement date through the next date of distribution;

(c) Trust general and administrative expenses, net of reimbursements, are recorded in the month they are included in the calculation of the monthly distribution amount; and

(d) Distributions payable are determined on a monthly basis and are payable to unitholders of record as of the last business day of each month or such later date as the Trustee determines is required to comply with applicable law or stock exchange requirements. However, cash distributions are made quarterly in January, April, July and October, and include interest earned from the monthly record dates to the date of distribution.

This basis for reporting distributable income is considered to be the most meaningful because distributions to the unitholders for a month are based on net cash receipts for such month. However, these statements differ from financial statements prepared in accordance with accounting principles generally accepted in the United States of America because under such principles, royalty income for a month would be based on net proceeds from production for such month without regard to when calculated or received and interest income for a month would be calculated only through the end of such month.

Note 3 Legal Proceedings

There are no pending legal proceedings to which the Trust is a named party. The Trustee has been advised by PNR, ConocoPhillips and BP Amoco that it is subject to litigation in the ordinary course of business for certain matters that include the Royalty Properties. While each of the working interest owners has advised the Trustee that it does not currently believe any of the pending litigation will have a material adverse effect net to the Trust, in the event such matters were adjudicated or settled in a material amount and charges were made against Royalty income, such charges could have a material impact of future Royalty income.

Note 4 Income Tax Matters

In a technical advice memorandum dated February 26, 1982, the IRS advised the Dallas District Director that the Trust is classifiable as a grantor trust and not as an association taxable as a corporation. As a grantor trust, the Trust will incur no federal income tax liability. In addition, there is no state income tax liability for the period.

The Trustee assumes that some Trust Units are held by a middleman, as such term is broadly defined in U.S. Treasury Regulations (and includes custodians, nominees, certain joint owners, and brokers holding an interest for a custodian in street name). Therefore, the Trustee considers the Trust to be a non-mortgage widely held fixed investment trust ("WHFIT") for U.S. federal income tax purposes. Bank of New York Mellon Trust Company, N.A., 919 Congress Avenue, Austin, Texas 78701, telephone number 1-800-852-1422, is the representative of the Trust that will provide tax information in accordance with applicable U.S. Treasury Regulations governing the information reporting requirements of the Trust as a WHFIT.

Note 5 Excess Production Costs

For the nine months ended September 30, 2009, the Trust did not receive any Royalty income associated with the San Juan Basin Colorado royalty properties operated by BP due to excess production costs incurred during such period. Excess production costs result when costs, charges, and expenses attributable to a Working Interest Property exceed the revenue received from the sale of oil, gas, and other hydrocarbons produced from such property. Excess production costs related to the San Juan Basin Colorado properties were approximately $50,000 as of September 30, 2009. The excess production costs must be recovered by the Working Interest Owners before any distribution of Royalty income from the properties will be made to the Trust.

Note 6 Tax Assessment

PNR has advised the Trustee that it received a proposed assessment from the Kansas Department of Revenue on September 10, 2009, for additional tax, penalty and interest of approximately $4.1 million resulting primarily from the settlement of the lawsuit John Steven Alford and Robert Larrabee, individually and on behalf of a Plaintiff Class v. Pioneer Natural Resources USA, Inc. in early 2007. The portion of the tax assessment net to the Trust is approximately $158,000, which could adversely affect Trust distributions. PNR has submitted a written response objecting to the proposed assessment. No assurance can be made that any objections or disputed items raised by PNR will be successful.

Note 7 Recently Issued Pronouncements

In December 2008, the SEC announced that it had approved revisions designed to modernize the oil and gas company reserve reporting requirements. The most significant amendments to the requirements include the following:

- commodity prices economic producibility of reserves and discounted cash flows will be based on a 12-month average commodity price unless contractual arrangements designate the price to be used;

- disclosure of unproved reserves probable and possible reserves may be disclosed separately on a voluntary basis;

- proved undeveloped reserve guidelines reserves may be classified as proved undeveloped if there is a high degree of confidence that the quantities will be recovered;

- reserve estimation using new technologies reserves may be estimated through the use of reliable technology in addition to flow tests and production history; and

- nontraditional resources the definition of oil and gas producing activities will expand and focus on the marketable product rather than the method of extraction.

The rules are effective for fiscal years ending on or after December 31, 2009, and early adoption is not permitted. The Trust is currently evaluating the new SEC rules and proposed FASB Accounting Standards Update assessing the impact they will have on its reported oil and gas reserves. The SEC is coordinating with the FASB to obtain the revisions necessary to U.S. GAAP concerning financial accounting and reporting by oil and gas producing companies and disclosures about oil and gas producing activities to provide consistency with the new rules. During September 2009, the FASB issued an exposure draft of a proposed Accounting Standards Update "Oil and Gas Reserves Estimation and Disclosures." The proposed update would amend existing standards to align the reserves calculation and disclosure requirements in the SEC rules. As proposed, the update would be effective for annual reporting periods ending on or after December 31, 2009, and would be applied prospectively as a change in estimate.

In June 2009, the FASB established the FASB Accounting Standards Codification (Codification), which officially commenced July 1, 2009, to become the source of authoritative US GAAP recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases of the SEC under authority of federal securities laws are also sources of authoritative US GAAP for SEC registrants. Generally, the Codification is not expected to change US GAAP. All other accounting literature excluded from the Codification will be considered nonauthoritative. The Codification is effective for financial statements issued for interim and annual periods ending after September 15, 2009. We adopted the new standards for our quarter ending September 30, 2009. All references to authoritative accounting literature are now referenced in accordance with the Codification.

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

The following review of the Trust's financial condition and results of operations should be read in conjunction with the financial statements and notes thereto. The discussion of net production attributable to the Hugoton and San Juan properties represents production volumes that are to a large extent hypothetical as the Trust does not own and is not entitled to any specific production volumes. See Note 7 to the financial statements in the Trust's Annual Report on Form 10-K for the year ended December 31, 2008. Any discussion of "actual" production volumes represents the hydrocarbons that were produced from the properties in which the Trust has an overriding royalty interest.

The Trust is a passive entity whose purposes are limited to: (1) converting the Royalties to cash, either by retaining them and collecting the proceeds of production (until production has ceased or the Royalties are otherwise terminated) or by selling or otherwise disposing of the Royalties; and (2) distributing such cash, net of amounts for payments of liabilities to the Trust, to the unitholders. The Trust has no sources of liquidity or capital resources other than the revenues, if any, attributable to the Royalties and interest on cash held by the Trustee as a reserve for liabilities or for distribution.

Note Regarding Forward-Looking Statements

This Form 10-Q includes "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements other than statements of historical facts included in this Form 10-Q, including without limitation the statements under "Management's Discussion and Analysis of Financial Condition and Results of Operations," are forward-looking statements. Although the Working Interest Owners have advised the Trust that they believe that the expectations reflected in the forward-looking statements contained herein are reasonable, no assurance can be given that such expectations will prove correct. Important factors that could cause actual results to differ materially from expectations ("Cautionary Statements") are disclosed in this Form 10-Q and in the Trust's Annual Report on Form 10-K for the year ended December 31, 2008, including under "Item 1A. Risk Factors." All subsequent written and oral forward-looking statements attributable to the Trust or persons acting on its behalf are expressly qualified in their entirety by the Cautionary Statements.

SUMMARY OF ROYALTY INCOME, PRODUCTION AND AVERAGE PRICES
(Unaudited)

Royalty income is computed after deducting the Trust's proportionate share of capital costs, operating costs and interest on any cost carryforward from the Trust's proportionate share of "Gross Proceeds," as defined in the Conveyance. The following summary illustrates the net effect of the components of the actual Royalty computation for the periods indicated:

	Three Months Ended September 30,			
	2009		2008	
	Natural Gas	Oil, Condensate and Natural Gas Liquids	Natural Gas	Oil, Condensate and Natural Gas Liquids
The Trust's proportionate share of Gross Proceeds(1)	1,061,433	729,413	3,911,028	1,691,366
Less the Trust's proportionate share of:				
Capital costs recovered	(84,302)	(74,076)	(96,995)	(55,805)
Operating costs	(445,159)	(254,973)	(637,544)	(276,932)
Net Proceeds	531,972	400,364	3,176,489	1,358,629
Royalty income(2)	522,856	400,364	3,176,489	1,358,629
Average sales price	$ 2.53	$ 27.31	$ 9.11	$ 65.76
	(Mcf)	(Bbls)	(Mcf)	(Bbls)
Net production volumes attributable to the Royalty paid(3)	206,268	14,662	348,675	20,662

	Nine Months Ended September 30,			
	2009		2008	
	Natural Gas	Oil, Condensate and Natural Gas Liquids	Natural Gas	Oil, Condensate and Natural Gas Liquids
The Trust's proportionate share of Gross Proceeds(1)	3,769,113	2,049,990	9,185,133	4,822,715
Less the Trust's proportionate share of:				
Capital costs recovered	(458,834)	(288,594)	(388,940)	(230,863)
Operating costs	(1,587,447)	(731,667)	(1,654,691)	(837,114)
Net Proceeds	1,722,832	1,029,729	7,141,502	3,754,738
Royalty income(2)	1,773,639	1,029,729	7,141,502	3,754,738
Average sales price	$ 3.13	$ 26.36	$ 7.41	$ 60.75
	(Mcf)	(Bbls)	(Mcf)	(Bbls)
Net production volumes attributable to the Royalty paid(3)	567,224	39,064	956,096	61,958

(1) Gross Proceeds from natural gas liquids attributable to the Hugoton and San Juan Basin Properties are net of a volumetric in-kind processing fee retained by PNR and ConocoPhillips, respectively.

(2) As a result of excess production costs incurred in one monthly operating period and then recovered in a subsequent monthly operating period(s), the Royalty income paid to the Trust may not agree to the Trust's royalty interest in the Net Proceeds. Excess production costs related to the San Juan Basin Colorado properties operated by BP were approximately $50,000 as of September 30, 2009. The excess production costs must be recovered by the Working Interest Owners before any distribution of Royalty income will be made to the Trust.

(3) Net production volumes attributable to the Royalty are determined by dividing Royalty income by the average sales price received.

Three Months Ended September 30, 2009 and 2008

Financial Review

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008
Royalty income	$ 923,220	$ 4,535,119
Interest income		10,840
General and administrative expense	(60,619)	(35,801)
Distributable income	$ 862,601	$ 4,510,158
Distributable income per unit	$ 0.4629	$ 2.4201
Units outstanding	1,863,590	1,863,590

The Trust's Royalty income was $923,220 in the third quarter 2009, a decrease of approximately 80% as compared to $4,535,119 in the third quarter of 2008, primarily as a result of lower natural gas and natural gas liquids prices in the third quarter of 2009 as compared to the third quarter of 2008.

The distributable income of the Trust for each period includes the Royalty income received from the working interest owners during such period, plus interest income earned to the date of distribution (if any). Trust administration expenses are deducted in the computation of distributable income. Distributable income for the quarter ended September 30, 2009 was $862,601, representing $.4629 per unit, compared to $4,510,158, representing $2.4201 per unit, for the quarter ended September 30, 2008. Based on 1,863,590 units outstanding for the quarters ended September 30, 2009 and 2008, respectively, the per unit distributions were as follows:

	2009	2008
April	$ 0.1536	$ 0.7699
May	0.1572	0.7889
September	0.1521	0.8613
	$ 0.4629	$ 2.4201

Operational Review

Hugoton Field

Natural gas and natural gas liquids production attributable to the Royalty from the Hugoton field accounted for approximately 38% of the Royalty income of the Trust during the third quarter of 2009.

PNR has advised the Trust that since June 1, 1995 natural gas produced from the Hugoton field has generally been sold under short-term and multi-month contracts at market clearing prices to multiple purchasers recently including Greely Gas and Oneok Energy Marketing, Inc. PNR has advised the Trust that it expects to continue to market gas production from the Hugoton field under short-term and multi-month contracts. As discussed below, overall market prices received for natural gas from the Hugoton Royalty Properties were significantly lower in the third quarter of 2009 compared to the third quarter of 2008.