MESA ROYALTY TRUST/TX
Form 10-Q
August 14, 2007

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2007

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: 1-07884

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 Trust Company, N.A., Trustee	
919 Congress Avenue	
Austin, Texas	**78701**
(Address of Principal Executive Offices)	(Zip Code)

1-800-852-1422/512-479-2562

(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 x No o

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 o Accelerated filer x Non-accelerated filer 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 x

Indicate the number of shares outstanding of each of the registrant s classes of common stock, as of the latest practicable date. As of August 9, 2007 1,863,590 Units of Beneficial Interest in Mesa Royalty Trust.

PART I FINANCIAL INFORMATION

Item 1. *Financial Statements.*

MESA ROYALTY TRUST
STATEMENTS OF DISTRIBUTABLE INCOME
(Unaudited)

	Three Months Ended June 30, 2007	2006	Six Months Ended June 30, 2007	2006
Royalty income	$ 2,662,923	$ 2,472,887	$ 5,226,004	$ 6,053,237
Interest income	21,873	6,480	44,491	14,342
General and administrative expense	(33,788)	(16,468)	(46,842)	(38,433)
Distributable income	$ 2,651,008	$ 2,462,899	$ 5,223,653	$ 6,029,146
Distributable income per unit	$ 1.4225	$ 1.3216	$ 2.8030	$ 3.2352
Units outstanding	1,863,590	1,863,590	1,863,590	1,863,590

STATEMENTS OF ASSETS, LIABILITIES AND TRUST CORPUS

	June 30, 2007 (Unaudited)	December 31, 2006
ASSETS		
Cash and short-term investments	$ 2,629,135	$ 1,725,732
Interest receivable	21,873	6,551
Net overriding royalty interest in oil and gas properties	42,498,034	42,498,034
Accumulated amortization	(34,587,091)	(34,395,319)
Total assets	$ 10,561,951	$ 9,834,998
LIABILITIES AND TRUST CORPUS		
Distributions payable	$ 2,651,008	$ 1,732,283
Trust corpus (1,863,590 units of beneficial interest authorized and outstanding)	7,910,943	8,102,715
Total liabilities and trust corpus	$ 10,561,951	$ 9,834,998

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

MESA ROYALTY TRUST
STATEMENTS OF CHANGES IN TRUST CORPUS
(Unaudited)

	Three Months Ended June 30, 2007	2006	Six Months Ended June 30, 2007	2006
Trust corpus, beginning of period	$ 8,008,765	$ 8,415,540	$ 8,102,715	$ 8,521,268
Distributable income	2,651,008	2,462,899	5,223,653	6,029,146
Distributions to unitholders	(2,651,008)	(2,462,899)	(5,223,653)	(6,029,146)
Amortization of net overriding royalty interest	(97,822)	(103,103)	(191,772)	(208,831)
Trust corpus, end of period	$ 7,910,943	$ 8,312,437	$ 7,910,943	$ 8,312,437

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

MESA ROYALTY TRUST
NOTES TO FINANCIAL STATEMENTS
(Unaudited)

Note 1 Trust Organization

The Mesa Royalty Trust (the Trust) was created on November 1, 1979 when Mesa Petroleum Co. conveyed to the Trust a 90% net profits overriding royalty interest (the Royalty) 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 (collectively, the Royalty Properties). Mesa Petroleum Co. was the predecessor to Mesa Limited Partnership (MLP), the predecessor to MESA Inc. On April 30, 1991, MLP sold its interests in the Royalty Properties located in the San Juan Basin field to ConocoPhillips (successor by merger to Conoco, Inc.). 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 and a few wells located in Southwest Colorado near the New Mexico border, 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. The terms working interest owner and Working Interest Owners generally refer to the operators of the Royalty Properties as described above, unless the context in which such terms are used indicates otherwise.

Effective October 2, 2006, the Bank of New York Trust Company, N.A. (the Trustee) succeeded JPMorgan Chase Bank, N.A. as Trustee of the Trust. JPMorgan Chase Bank, N.A. was 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 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 Bank of New York Trust Company, N.A. (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 periods. 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 Form 10-K for the year ended December 31, 2006.

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 for the preceeding month. The Trust Indenture was amended in 1985, the effect of which was an overall reduction of approximately 88.56% in the size of the Trust; therefore, the Trust is now entitled to receive 90% of 11.44% of the net proceeds for the preceding month. Generally, net proceeds means the excess of the amounts received by the Working Interest Owners from sales of oil and gas from the Royalty Properties over operating and capital costs incurred.

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 accrue;

(d) amortization of the net overriding royalty interests, which is calculated on a unit-of-production basis, is charged directly to trust corpus since such amount does not affect distributable income; and

(e) 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 other day as the Trustee determines is required to comply with legal 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 thought to be the most meaningful because distributions to the unitholders for a month are based on net cash receipts for such month. However, it will differ from the basis used for financial statements prepared in accordance with accounting principles generally accepted in the United States of America because under these accounting 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. PNR has advised the Trustee that the previously reached 2006 settlement in the lawsuit *John Steven Alford and Robert Larrabee, individually and on behalf of a Plaintiff Class v. Pioneer Natural Resources USA, Inc.,* filed in the 26th Judicial District Court, Stevens County, Kansas, was approved in the first quarter of 2007 by the Judge and the case was finalized in April 2007. The plaintiffs in the above noted lawsuit were royalty owners in oil and gas properties located in the Hugoton field, which are owned by Pioneer USA, a subsidiary of Pioneer Natural Resources Company (Pioneer). The plaintiffs sued a predecessor company to Pioneer USA asserting various claims relating to alleged improper deductions in the calculation of royalties.

Under the terms of the agreement, Pioneer USA agreed to make cash payments to settle the plaintiffs claims with respect to production occurring on and before December 31, 2005. Pioneer USA also agreed to adjust the manner in which royalty payments to the class members will be calculated for production occurring on and after January 1, 2006.

Pioneer s portion of the cash payment is approximately $32,700,000. Pioneer agreed to pay the cash portion in two installments. Pioneer has advised the Trustee that the portion of the cash payments net to the Trust s interest was approximately $1,000,000 paid on September 30, 2006 and an expected payment of approximately $900,000 payable on September 30, 2007. Pioneer USA will initially pay the costs attributable to the Trust s interest but will recover these costs through payments out of future gross proceeds on the Trust s properties. The $1,000,000 attributable to the Trust paid on September 30, 2006, was deducted from royalty income in the fourth quarter of 2006 and the $900,000 anticipated to be paid on September 30, 2007, will be deducted from the Trust s future royalty income. Accordingly, Royalty income to the Trust will be significantly reduced until all of these payments, together with any applicable interest as provided under the overriding royalty conveyance of the Trust s properties, are recouped by Pioneer USA.

Pioneer has advised the Trust that under the terms of the settlement agreement, the amounts required to be paid will be reduced if potential participating class members elect not to participate in the settlement by opting out under procedures established by the court. The settlement agreement contains a refund mechanism to address the circumstance where potential participating parties opt out after one of the funding installments is made. Pioneer cannot predict whether opt-outs will occur, or in what magnitude, but in the event that opt-outs occur triggering a refund, Pioneer will advise us of the refund amount attributable to the Trust.

Note 4 Federal 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.

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 2006 Annual Report on Form 10-K. 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 Form 10-K for the year ended December 31, 2006, 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 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 Royalty conveyance. The following summary illustrates the net effect of the components of the actual Royalty computation for the periods indicated:

	Three Months Ended June 30, 2007		2006	
	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)	2,765,232	999,843	$ 2,947,759	$ 869,129
Less the Trust s proportionate share of:				
Capital costs recovered(2)	(338,001)		(225,735)	
Operating costs	(646,905)	(117,246)	(878,555)	(70,737)
Withheld revenues(3)			(168,974)	