

MESA ROYALTY TRUST/TX  
Form 10-Q  
July 28, 2009

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## SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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### 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 June 30, 2008**

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**

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## MESA ROYALTY TRUST

(Exact Name of Registrant as Specified in its Charter)

**Texas**  
(State or other Jurisdiction of  
Incorporation or Organization)

**76-6284806**  
(I.R.S. Employer  
Identification No.)

**The Bank of New York Mellon Trust  
Company,  
N.A., Trustee  
919 Congress Avenue  
Austin, Texas**

(Address of Principal Executive Offices)

**78701**  
(Zip Code)

**1-800-852-1422**  
(Registrant's Telephone Number, Including Area Code)

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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 o

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

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

As of July 27, 2009 1,863,590 Units of Beneficial Interest were outstanding in Mesa Royalty Trust.

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## PART I FINANCIAL INFORMATION

Item 1. *Financial Statements.*

**MESA ROYALTY TRUST**  
**STATEMENTS OF DISTRIBUTABLE INCOME**

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Royalty income	\$3,476,622	\$2,662,923	\$6,361,131	\$5,226,004
Interest income	11,460	21,873	25,994	44,491
General and administrative expense	(33,257)	(33,788)	(60,275)	(46,842)
Distributable income	\$3,454,825	\$2,651,008	\$6,326,850	\$5,223,653
Distributable income per unit	\$ 1.8539	\$ 1.4225	\$ 3.3950	\$ 2.8030
Units outstanding	1,863,590	1,863,590	1,863,590	1,863,590

**STATEMENTS OF ASSETS, LIABILITIES AND TRUST CORPUS**

	June 30, 2008	December 31, 2007
(Unaudited)		
<b>ASSETS</b>		
Cash and short-term investments	\$ 3,443,366	\$ 3,783,453
Interest receivable	11,460	27,904
Net overriding royalty interest in oil and gas properties	42,498,034	42,498,034
Accumulated amortization	(35,094,140)	(34,805,821)
Total assets	\$ 10,858,720	\$ 11,503,570
<b>LIABILITIES AND TRUST CORPUS</b>		
Distributions payable	\$ 3,454,825	\$ 3,811,357
Trust corpus (1,863,590 units of beneficial interest authorized and outstanding)	7,403,895	7,692,213
Total liabilities and trust corpus	\$ 10,858,720	\$ 11,503,570

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

**MESA ROYALTY TRUST**

**STATEMENTS OF CHANGES IN TRUST CORPUS**

**(Unaudited)**

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Trust corpus, beginning of period	\$ 7,551,171	\$ 8,008,765	\$ 7,692,213	\$ 8,102,715
Distributable income	3,454,825	2,651,008	6,326,850	5,223,653
Distributions to unitholders	(3,454,825)	(2,651,008)	(6,326,850)	(5,223,653)
Amortization of net overriding royalty interest	(147,276)	(97,822)	(288,318)	(191,772)
Trust corpus, end of period	\$ 7,403,895	\$ 7,910,943	\$ 7,403,895	\$ 7,910,943

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

**MESA ROYALTY TRUST**

**STATEMENTS OF CHANGES IN TRUST CORPUS  
(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. The San Juan Basin Royalty Properties located in New Mexico are operated by ConocoPhillips. 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 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;

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(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, 2007.

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 accrue; 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 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 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. 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 PNR, a subsidiary of Pioneer. The plaintiffs sued a predecessor company to PNR asserting various claims relating to alleged improper deductions in the calculation of royalties.

Under the terms of the agreement, PNR agreed to make cash payments to settle the plaintiffs' claims with respect to production occurring on and before December 31, 2005. PNR 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.

The Trustee has been advised by 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 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.

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 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.

**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, 2007. 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, 2007, 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 June 30,			
	2008		2007	
	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)	2,870,529	1,553,475	2,765,232	999,843
Less the Trust's proportionate share of:				
Capital costs recovered	(101,262)	(55,210)	(338,001)	
Operating costs	(528,936)	(261,974)	(646,905)	(117,246)
<b>Royalty income</b>	<b>2,240,331</b>	<b>1,236,291</b>	<b>1,780,326</b>	<b>882,597</b>
Average sales price	\$ 7.28	\$ 57.98	\$ 5.90	\$ 36.19
	(Mcf)	(Bbls)	(Mcf)	(Bbls)
Net production volumes attributable to the Royalty paid	307,282	21,301	301,865	24,389

	Six Months Ended June 30,			
	2008		2007	
	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)	5,274,113	3,131,348	5,377,199	1,921,699
Less the Trust's proportionate share of:				
Capital costs recovered	(291,959)	(175,040)	(577,441)	
Operating costs	(1,017,139)	(560,192)	(1,365,970)	(129,483)
<b>Royalty income</b>	<b>3,965,015</b>	<b>2,396,116</b>	<b>3,433,788</b>	<b>1,792,216</b>
Average sales price	\$ 6.52	\$ 58.35	\$ 5.78	\$ 35.73
	(Mcf)	(Bbls)	(Mcf)	(Bbls)
Net production volumes attributable to the Royalty paid	606,814	41,313	593,584	50,165

(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.

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**Three Months Ended June 30, 2008 and 2007**

### *Financial Review*

	<b>Three Months Ended June 30,</b>	
	<b>2008</b>	<b>2007</b>
Royalty income	\$3,476,622	\$2,662,923
Interest income	11,460	21,873
General and administrative expense	(33,257)	(33,788)
 Distributable income	 \$3,454,825	 \$2,651,008
 Distributable income per unit	 \$ 1.8539	 \$ 1.4225
 Units outstanding	 1,863,590	 1,863,590

The Trust's Royalty income was \$3,476,622 in the second quarter 2008, an increase of approximately 31% as compared to \$2,662,923 in the second quarter of 2007, primarily as a result of higher natural gas and natural gas liquids prices and reduced capital costs in the second quarter of 2008 as compared to the second quarter of 2007.

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. Trust administration expenses are deducted in the computation of distributable income. Distributable income for the quarter ended June 30, 2008 was \$3,454,825, representing \$1.8539 per unit, compared to \$2,651,008, representing \$1.4225 per unit, for the quarter ended June 30, 2007. Based on 1,863,590 units outstanding for the quarters ended June 30, 2008 and 2007, respectively, the per unit distributions were as follows:

	<b>2008</b>	<b>2007</b>
April	\$0.5303	\$0.4344
May	0.6552	0.4844
June	0.6684	0.5037
	 \$1.8539	 \$1.4225

### *Operational Review*

#### *Hugoton Field*

Natural gas and natural gas liquids production attributable to the Royalty from the Hugoton field accounted for approximately 42% of the Royalty income of the Trust during the second quarter of 2008.

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

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Hugoton Royalty Properties were significantly higher in the second quarter of 2008 compared to the second quarter of 2007.

In June 1994, PNR entered into a Gas Transportation Agreement ("Gas Transportation Agreement") with Western Resources, Inc. ("WRI") for a primary term of five years commencing June 1, 1995. This contract has renewed on a year-to-year basis since June 1, 2001. PNR extended the contract June 1, 2009. Pursuant to the Gas Transportation Agreement, WRI agreed to compress and transport up to 160 MMcf per day of gas and redeliver such gas to PNR at the inlet of PNR's Satanta Plant. PNR agreed to pay WRI a fee of \$0.06 per Mcf escalating 4% annually as of June 1, 1996. This Gas Transportation Agreement was assigned to Kansas Gas Service ("Oneok").

Royalty income attributable to the Hugoton Royalty increased to \$1,472,388 in the second quarter of 2008, as compared to \$1,146,737 in the second quarter of 2007. The increase in Royalty income was primarily due to higher natural gas and natural gas liquid prices. The average price received in the second quarter of 2008 for natural gas and natural gas liquids sold from the Hugoton Royalty Properties was \$7.53 per Mcf and \$63.26 per barrel, respectively, compared to \$6.32 per Mcf and \$37.27 per barrel, respectively, during the same period in 2007. Net production attributable to the Hugoton Royalty was 135,263 Mcf of natural gas and 7,186 barrels of natural gas liquids in the second quarter of 2008 compared to 135,978 Mcf of natural gas and 7,710 barrels of natural gas liquids in the second quarter of 2007. Actual production volumes attributable to the Hugoton properties decreased to 166,945 Mcf of natural gas and increased to 8,869 barrels of natural gas liquids in the second quarter of 2008 as compared to 185,980 Mcf of natural gas and 7,715 barrels of natural gas liquids for the same period in 2007.

There were no capital expenditures on these properties in the second quarter of 2008, compared to \$6,892 in the second quarter of 2007. Operating costs were \$345,659 in the second quarter of 2008, an increase of approximately 12% as compared to \$308,692 in the second quarter of 2007. The increase in operating costs between the three months ended June 30, 2008 and the three months ended June 30, 2007 is due to higher rates charged by service providers.

Beginning July 1, 2007 the Hugoton and Panoma fields will be considered a single, common source of supply and operated under a single combined Basic Proration Order (BPO). After July 1, 2007 the wells in each of these fields was allowed to produce at their open flow potential and were no longer subject to allowable restrictions. Because no objection was received by December 31, 2007, any and all overage or underage that a well accrued was cancelled.

### *San Juan Basin*

Royalty income from the San Juan Basin Royalty Properties is calculated and paid to the Trust on a state-by-state basis. Substantially all of the Royalty income from the San Juan Basin Royalty Properties is attributable to the Royalty Properties located in the state of New Mexico. The Royalty income from the San Juan Basin Royalty Properties located in the state of New Mexico was \$1,811,524 during the second quarter of 2008 as compared with \$1,356,238 in the second quarter of 2007. The average price received in the second quarter of 2008 for natural gas sold from the San Juan Basin Royalty Properties located in the state of New Mexico was \$7.27 per Mcf and \$55.37 per barrel, respectively, compared to \$5.68 per Mcf and \$35.69 per barrel during the same period in 2007. Net production attributable to the San Juan Basin Royalty located in New Mexico was 141,367 Mcf of natural gas and 14,103 barrels of natural gas liquids in the second quarter of 2008 as compared to

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133,961 Mcf of natural gas and 16,679 barrels of natural gas liquids in the second quarter of 2007. Actual production volumes attributable to the San Juan Basin properties located in the state of New Mexico decreased to 189,010 Mcf of natural gas and 17,922 barrels of natural gas liquids in the second quarter of 2008 as compared to 249,876 Mcf of natural gas and 20,493 barrels of natural gas liquids for the same period in 2007. The decrease in actual production volume for the three month period ended June 30, 2008 compared to the same period 2007 was due to a mandatory shut in of several wells as a result of a gas plant fire.

Capital expenditures on the San Juan Basin Royalty Properties located in the state of New Mexico were \$156,472 in the second quarter of 2008, a decrease of approximately 53% as compared to \$331,109 in the second quarter of 2007. This decrease is due to decreased drilling activity in the second quarter of 2008 when compared to the second quarter of 2007. Operating costs were \$398,395 in the second quarter of 2008, a decrease of approximately 9% as compared to \$437,922 in the second quarter of 2007. The decrease in operating expenses for the three month period ended June 30, 2008 compared to the same period in 2007 was due to a reduction in lease inspections and a reduction in well workover expenses.

The Trust's interest in the San Juan Basin was conveyed from PNR's working interest in 31,328 net producing acres in northwestern New Mexico and southwestern Colorado.

The costs related to the San Juan Basin, Colorado drilling program were recovered in December 2004. However, subsequent earnings after recovery of costs were not remitted to the Trust until December 2006. The cumulative earnings, including interest on undistributed earnings, reported to the Trust by the working interest owner through November 2006, totaled \$1,280,412. In December, BP remitted \$978,349 for payment of undistributed earnings from January 2005 through October 2006 and November 2006 earnings for the San Juan properties it operates. In July 2007, Red Willow remitted \$159,497 for payment of undistributed earnings from January 2005 through December 2006 for the properties it operates. BP communicated to the Trust these distributions represent all of the previously unpaid revenues. The Trustee is currently investigating the \$142,566 difference in the original estimate of unpaid proceeds of \$1,280,412 and the payment of \$1,137,846. Since Royalty income for the Trust is recorded on a cash basis, the earnings for the year ended December 31, 2006 were not recognized as income until the quarters ended December 31, 2006 and September 30, 2007.

Royalty income from the San Juan Basin Colorado Royalty Properties was \$192,710 during the second quarter of 2008, compared to \$159,948 during the second quarter of 2007. Net production attributable to the San Juan Basin Royalty Properties located in Colorado was 30,653 Mcf of natural gas during the second quarter of 2008, compared to 31,926 Mcf of natural gas during the second quarter of 2007. The average price received in the second quarter of 2008 for natural gas sold from the San Juan Basin Colorado Properties was \$6.29 compared to \$5.01 in the second quarter of 2007. Actual production volumes attributable to the San Juan Basin Colorado Properties decreased to 37,925 Mcf of natural gas in the second quarter of 2008 as compared to 35,433 Mcf of natural gas for the same period in 2007. Royalty income reported from BP is net of pre-main line production costs. These costs were charged to the Trust in error and as a result the royalty income for previous periods was reduced. Because royalty income recorded for a month is the amount computed and paid by BP the additional royalties, if any, will not be recorded until received.

Operating costs on these properties were \$46,856 in the second quarter of 2008, an increase of approximately 167% as compared to \$17,537 in the second quarter of 2007 due to an increase in drilling charges.

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Six Months Ended June 30, 2008 and 2007

### *Financial Review*

	Six Months Ended June 30,	
	2008	2007
Royalty income	\$6,361,131	\$5,226,004
Interest income	25,994	44,491
General and administrative expense	(60,275)	(46,842)
Distributable income	\$6,326,850	\$5,223,653
Distributable income per unit	\$ 3.3950	\$ 2.8030
Units outstanding	1,863,590	1,863,590

The Trust's Royalty income was \$6,361,131 for the six months ended June 30, 2008, an increase of approximately 22% as compared to \$5,226,004 for the six months ended June 30, 2007, primarily as a result of higher natural gas and natural gas liquid prices in the first six months of 2008 as compared to the first six months of 2007.

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. Trust administration expenses are deducted in the computation of distributable income. Distributable income for the six months ended June 30, 2008 was \$6,326,850, representing \$3.3950 per unit, compared to \$5,223,653, representing \$2.8030 per unit, for the six months ended June 30, 2007.

### *Operation Review*

#### *Hugoton Field*

Natural gas and natural gas liquids revenue from the Hugoton field attributable to the Royalty accounted for approximately 42% of the Royalty income of the Trust during the six months ended June 30, 2008.

Royalty income attributable to the Hugoton Royalty Properties increased to \$2,664,077 for the six months ended June 30, 2008 from \$2,332,498 for the same period in 2007 primarily due to increases in natural gas and natural gas liquids prices from the Hugoton Royalty Properties. The average price received in the first six months of 2008 for natural gas and natural gas liquids sold from the Hugoton field was \$6.80 per Mcf and \$60.97 per barrel, respectively, compared to \$6.11 per Mcf and \$37.48 per barrel, respectively, during the same period in 2007. Net production attributable to the Hugoton Royalty Properties decreased to 261,589 Mcf of natural gas and 14,478 barrels of natural gas liquids for the six months ended June 30, 2008 as compared to 270,956 Mcf of natural gas and 18,062 barrels of natural gas liquids for the six months ended June 30, 2007. Actual production volumes attributable to the Hugoton Royalty Properties decreased to 331,422 Mcf of natural gas and increased to 18,328 barrels of natural gas liquids in the six months ended June 30, 2008 as compared to 377,299 Mcf of natural gas and 18,071 barrels of natural gas liquids for the same period in 2007. The decrease in gas production and the increase in the natural gas liquids production for the six month period ended June 30, 2008 compared to the same period 2007 was primarily due to the nitrogen rejection unit being

down for a portion of January and February of 2007. The shut down of the nitrogen rejection increased the gas production while it decreased the natural gas liquids production.

The Hugoton capital expenditures were \$16,801 during the six months ended June 30, 2008, an increase of approximately 6% as compared to \$15,878 during the six months ended June 30, 2007. The increase in the capital expenditures was primarily due to the changes in quarterly capital spending at individual wells. Operating costs were \$688,979 during the six months ended June 30, 2008, an increase of approximately 9% as compared to \$634,402 during the six months ended June 30, 2007 due to price increases from vendors and suppliers.

#### *San Juan Basin*

The Royalty income from the San Juan Basin Royalty Properties located in the state of New Mexico was \$3,323,031 for the first six months of 2008 compared to \$2,512,185 in the first six months of 2007. The increase in Royalty income was due primarily to increased natural gas and natural gas liquid prices in the first six months of 2008 from the San Juan Basin properties. The average price received in the six months ended June 30, 2008 for natural gas and natural gas liquids sold from the San Juan Basin Royalty Properties located in the state of New Mexico was \$6.42 per Mcf and \$56.41 per barrel, respectively, compared to \$5.71 per Mcf and \$34.74 per barrel, respectively, during the same period in 2007. Net production attributable to the San Juan Basin Royalty located in New Mexico was 278,535 Mcf of natural gas and 26,821 barrels of natural gas liquids for the six months ended June 30, 2008 as compared to 244,808 Mcf of natural gas and 32,103 barrels of natural gas liquids for the six months ended June 30, 2007. Actual production volumes attributable to the San Juan Basin Royalty Properties decreased to 399,670 Mcf of natural gas and 35,342 barrels of natural gas liquids in the six months ended June 30, 2008 as compared to 467,178 Mcf of natural gas and 36,363 barrels of natural gas liquids for the same period in 2007. The decrease in natural gas liquid production volume for the six month period ended June 30, 2008 compared to the same period 2007 due to a production interruption caused by a gas plant fire in the first quarter of 2008.

San Juan-New Mexico capital expenditures were \$450,202 during the six months ended June 30, 2008, a decrease of approximately 20% as compared to \$561,563 during the six months ended June 30, 2007. This decrease is due to less drilling activity during the six months ended June 30, 2008 when compared to the six months ended June 30, 2007. Operating costs were \$822,924 during the six months ended June 30, 2008, a decrease of approximately 1% as compared to \$827,382 during the six months ended June 30, 2007.

Royalty income from the San Juan Basin Colorado Royalty Properties was \$374,023 for the six months ended June 30, 2008, compared to \$381,321 received during the same period in 2007. Net production attributable to the San Juan Basin Royalty Properties located in Colorado was 66,690 Mcf of natural gas during the six months ended June 30, 2008 with 77,821 volumes attributable to the Trust during the same period in 2007. The average price received for the six months ended June 30, 2008 for natural gas sold from the San Juan Basin Colorado Properties was \$5.56, compared to \$4.90 received during the same period in 2007. Actual production volumes attributable to the San Juan Basin Colorado Properties decreased to 77,798 Mcf of natural gas for the six months ended June 30, 2008 as compared to 84,613 Mcf of natural gas for the same period in 2007.

Operating costs on these properties were \$65,427 for the six months ended June 30, 2008, an increase of approximately 94% as compared to \$33,669 in the same period in 2007 due to an increase in drilling charges.

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

The Trust does not engage in any operations, and does not utilize market risk sensitive instruments, either for trading purposes or for other than trading purposes. The Trust's monthly distributions are highly dependent upon the prices realized from the sale of natural gas. Natural gas prices can fluctuate widely on a month-to-month basis in response to a variety of factors that are beyond the control of the Trust and the working interest owners. Factors that contribute to price fluctuation include, among others:

political conditions worldwide, in particular political disruption, war or other armed conflict in or affecting oil producing regions;

worldwide economic conditions;

weather conditions, including hurricanes and tropical storms in the Gulf of Mexico;

the supply and price of foreign natural gas;

the level of consumer demand;

the price and availability of alternative fuels;

the proximity to, and capacity of, transportation facilities; and

the effect of worldwide energy conservation measures.

Moreover, government regulations, such as regulation of natural gas transportation and price controls, can affect product prices in the long term.

**Item 4. *Controls and Procedures.***

*Evaluation of Disclosure Controls and Procedures.* The Trustee maintains disclosure controls and procedures designed to ensure that information required to be disclosed by the Trust in the reports that it files or submits under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and regulations. Disclosure controls and procedures include controls and procedures designed to ensure that information required to be disclosed by the Trust in the reports that it files or submits under the Exchange Act is accumulated and communicated by the working interest owners to The Bank of New York Trust Company, N.A., as Trustee of the Trust, and its employees who participate in the preparation of the Trust's periodic reports as appropriate to allow timely decisions regarding required disclosure.

As of the end of the period covered by this report, the trust officer acting on behalf of the Trustee responsible for the administration of the Trust conducted an evaluation of the Trustee's disclosure controls and procedures. The officer acting on behalf of the Trustee concluded that the Trust's disclosure controls and procedures were effective with respect to information by the Trustee and its employees but not effective with respect to information required to be communicated by all of the working interest owners.

Due to the contractual arrangements of (i) the Trust Indenture and (ii) the rights of the Trust under the Conveyance regarding information furnished by the working interest owners, the Trustee relies on information provided by the working interest owners, including (i) the status of litigation,

(ii) historical operating data, plans for future operating and capital expenditures and reserve information, (iii) information relating to projected production, and (iv) conclusions regarding reserves by their internal reserve engineers or other experts in good faith. See Part I Item 1A. "Risk Factors Trust unitholders and the Trustee have no control over the operation or development of the Royalty Properties and have little influence over operation or development" and " The Trustee relies upon the Working Interest Owners for information regarding the Royalty Properties" in the Trust's Annual Report on Form 10-K for the year ended December 31, 2007 for a description of certain risks relating to these arrangements and reliance, including filings such as this filing outside the time periods specified notwithstanding effective disclosure controls and procedures, of the Trustee regarding information under its control.

*Changes in Internal Control over Financial Reporting.* In connection with the evaluation by the Trustee of changes in internal control over financial reporting of the Trust that occurred during the Trust's last fiscal quarter, no change in the Trust's internal control over financial reporting was identified that has materially affected, or is reasonably likely to materially affect, the Trust's internal control over financial reporting. The Trustee notes for purposes of clarification that it has no authority over, has not evaluated and makes no statement concerning the internal control over financial reporting of the working interest owners.

## PART II OTHER INFORMATION

### Item 1. *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 PNR, a subsidiary of Pioneer. The plaintiffs sued a predecessor company to PNR asserting various claims relating to alleged improper deductions in the calculation of royalties.

Under the terms of the agreement, PNR agreed to make cash payments to settle the plaintiffs' claims with respect to production occurring on and before December 31, 2005. PNR 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 was approximately \$32,700,000. Pioneer agreed to pay the cash portion in two installments. Pioneer 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 \$986,138 payable on September 30, 2007. The approximate \$1,000,000 attributable to the Trust paid on September 30, 2006, was deducted from royalty income in the fourth quarter of 2006. In October 2007, Pioneer informed the Trustee that during the course of PNR's analysis of the payments under the terms of the settlement agreement, PNR has now determined that the Trust should not bear any portion of the second installment payment and that PNR should reimburse the Trust for the portion of the first installment payment previously charged to the Trust and paid in September 2006. As a result, PNR included a reimbursement of \$1,096,630, including interest in the amount of \$110,492, to



the distribution made to the Trust in October 2007 which was included in the Trust's fourth quarter receipts, and no portion of the second installment payment was charged to the Trust.

The Trustee has been advised by 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 on future Royalty income.

**Item 1A. Risk Factors.**

There have not been any material changes from risk factors previously disclosed in Item 1A. to Part 1 of the Trust's Annual Report on Form 10-K for the year ended December 31, 2007.

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**Item 6. Exhibits.**

(Asterisk indicates exhibit previously filed with the Securities and Exchange Commission and incorporated herein by reference. The Bank of New York Mellon Trust Company, N.A. is the successor trustee to JPMorgan Chase Bank, N.A. JPMorgan Chase Bank, N.A. was formerly known as The Chase Manhattan Bank and is successor by mergers to the original name of the Trustee, Texas Commerce Bank National Association.)

		<b>SEC File or Registration Number</b>	<b>Exhibit Number</b>
4(a)*	Mesa Royalty Trust Indenture between Mesa Petroleum Co. and Texas Commerce Bank National Association, as Trustee, dated November 1, 1979	2-65217	1(a)
4(b)*	Overriding Royalty Conveyance between Mesa Petroleum Co. and Texas Commerce Bank, as Trustee, dated November 1, 1979	2-65217	1(b)
4(c)*	First Amendment to the Mesa Royalty Trust Indenture dated as of March 14, 1985 (Exhibit 4(c) to Form 10-K for year ended December 31, 1984 of Mesa Royalty Trust)	1-07884	4(c)
4(d)*	Form of Assignment of Overriding Royalty Interest, effective April 1, 1985, from Texas Commerce Bank National Association, as Trustee, to MTR Holding Co. (Exhibit 4(d) to Form 10-K for year ended December 31, 1984 of Mesa Royalty Trust)	1-07884	4(d)
4(e)*	Purchase and Sale Agreement, dated March 25, 1991, by and among Mesa Limited Partnership, Mesa Operating Limited Partnership and Conoco, as amended on April 30, 1991 (Exhibit 4(e) to Form 10-K for year ended December 31, 1991 of Mesa Royalty Trust)	1-07884	4(e)
31	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002		
32	Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002		



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

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