

PERMIAN BASIN ROYALTY TRUST  
Form 10-Q  
November 07, 2008

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**FORM 10-Q**

**Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the Quarterly Period ended September 30, 2008**

**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 1-8033**

**PERMIAN BASIN ROYALTY TRUST**

**(Exact Name of Registrant as Specified in the Permian Basin Royalty Trust Indenture)**

Texas  
(State or Other Jurisdiction of  
Incorporation or Organization)

75-6280532  
(I.R.S. Employer Identification No.)

U.S. Trust, Bank of America  
Private Wealth Management  
Trust Department  
901 Main Street  
Dallas, Texas 75202  
(Address of Principal Executive  
Offices; Zip Code)  
(214) 209-2400

(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  No

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

Number of Units of beneficial interest of the Trust outstanding at November 1, 2008: 46,608,796.

**PERMIAN BASIN ROYALTY TRUST**  
**PART I FINANCIAL INFORMATION**

**Item 1. Financial Statements**

The condensed financial statements included herein have been prepared by Bank of America, N.A. as Trustee for the Permian Basin Royalty Trust, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in annual financial statements have been condensed or omitted pursuant to such rules and regulations, although the Trustee believes that the disclosures are adequate to make the information presented not misleading. It is suggested that these condensed financial statements be read in conjunction with the financial statements and the notes thereto included in the Trust's latest annual report on Form 10-K. In the opinion of the Trustee, all adjustments, consisting only of normal recurring adjustments, necessary to present fairly the assets, liabilities and trust corpus of the Permian Basin Royalty Trust at September 30, 2008, and the distributable income for the three-month and nine-month periods ended September 30, 2008 and 2007 and the changes in trust corpus for the nine-month periods ended September 30, 2008 and 2007 have been included. The distributable income for such interim periods is not necessarily indicative of the distributable income for the full year. Deloitte & Touche LLP, an independent registered public accounting firm, has made a limited review of the condensed financial statements as of September 30, 2008 and for the three-month and nine-month periods ended September 30, 2008 and 2007 as stated in their report included herein.

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Unit Holders of Permian Basin Royalty Trust and  
Bank of America, N.A., Trustee

We have reviewed the accompanying condensed statement of assets, liabilities and trust corpus of Permian Basin Royalty Trust as of September 30, 2008, and the related condensed statements of distributable income for the three-month and nine-month periods ended September 30, 2008 and 2007 and changes in trust corpus for the nine-month periods ended September 30, 2008 and 2007. These condensed financial statements are the responsibility of the Trustee.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole.

Accordingly, we do not express such an opinion.

As described in Note 1 to the condensed financial statements, these condensed financial statements have been prepared on a modified cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

Based on our reviews, we are not aware of any material modifications that should be made to such condensed interim financial statements for them to be in conformity with the basis of accounting described in Note 1.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the statement of assets, liabilities and trust corpus of Permian Basin Royalty Trust as of December 31, 2007, and the related statements of distributable income and changes in trust corpus for the year then ended (not presented herein); and in our report dated March 11, 2008, we expressed an unqualified opinion on those financial statements. In our opinion, the information set forth in the accompanying condensed statement of assets, liabilities and trust corpus as of December 31, 2007, is fairly stated, in all material respects, in relation to the statement of assets, liabilities and trust corpus from which it has been derived.

/s/ Deloitte & Touche LLP

Dallas, Texas

November 6, 2008

**PERMIAN BASIN ROYALTY TRUST  
CONDENSED STATEMENTS OF ASSETS, LIABILITIES AND TRUST CORPUS**

|   | September 30,<br>2008<br>(Unaudited) | December<br>31,<br>2007 |
|---|--------------------------------------|-------------------------|
| <b>ASSETS</b>   |                                      |                         |
| Cash and short-term investments   | \$ 11,500,938                        | \$ 8,173,207            |
| Net overriding royalty interests in producing oil and gas properties (net of accumulated amortization of \$9,777,015 and \$9,681,281 at September 30, 2008 and December 31, 2007, respectively) | 1,198,202                            | 1,293,935               |
| <b>TOTAL ASSETS</b>   | <b>\$ 12,699,140</b>                 | <b>\$ 9,467,142</b>     |
| <b>LIABILITIES AND TRUST CORPUS</b>   |                                      |                         |
| Distribution payable to Unit holders  | \$ 11,500,938                        | \$ 8,173,207            |
| Commitments and contingencies<br>Trust corpus - 46,608,796 Units of beneficial interest authorized and outstanding  | 1,198,202                            | 1,293,935               |
| <b>TOTAL LIABILITIES AND TRUST CORPUS</b>   | <b>\$ 12,699,140</b>                 | <b>\$ 9,467,142</b>     |

The accompanying notes to condensed financial statements are an integral part of these statements.

**PERMIAN BASIN ROYALTY TRUST**  
**CONDENSED STATEMENTS OF DISTRIBUTABLE INCOME (UNAUDITED)**

|   | THREE MONTHS ENDED |               | NINE MONTHS ENDED |               |
|---|--------------------|---------------|-------------------|---------------|
|   | September 30       |               | September 30      |               |
|   | 2008               | 2007          | 2008              | 2007          |
| Royalty income                                      | \$ 35,552,084      | \$ 18,000,323 | \$ 89,237,008     | \$ 45,320,284 |
| Interest income                                     | 20,118             | 28,609        | 75,332            | 86,602        |
|   | 35,572,202         | 18,028,932    | 89,312,340        | 45,406,886    |
| General and administrative expenditures             | (134,748)          | (99,342)      | (848,993)         | (743,962)     |
| Distributable income                                | \$ 35,437,454      | \$ 17,929,590 | \$ 88,463,347     | \$ 44,662,924 |
| Distributable income per Unit (46,608,796<br>Units) | \$ .76             | \$ .38        | \$ 1.90           | \$ .96        |

The accompanying notes to condensed financial statements are an integral part of these statements.

**PERMIAN BASIN ROYALTY TRUST**  
**CONDENSED STATEMENTS OF CHANGES IN TRUST CORPUS (UNAUDITED)**

|  | NINE MONTHS ENDED |              |
|--|-------------------|--------------|
|  | September 30      |              |
|  | 2008              | 2007         |
| Trust corpus, beginning of period                | \$ 1,293,935      | \$ 1,439,214 |
| Amortization of net overriding royalty interests | (95,733)          | (103,408)    |
| Distributable income                             | 88,463,347        | 44,662,924   |
| Distributions declared                           | (88,463,347)      | (44,662,924) |
| Total Trust Corpus, end of period                | \$ 1,198,202      | \$ 1,335,806 |
| Distributions per unit                           | \$ 1.90           | \$ .96       |

The accompanying notes to condensed financial statements are an integral part of these statements.

**PERMIAN BASIN ROYALTY TRUST**  
**NOTES TO CONDENSED FINANCIAL STATEMENTS (UNAUDITED)**

**1. BASIS OF ACCOUNTING**

The Permian Basin Royalty Trust ( Trust ) was established as of November 1, 1980. The net overriding royalties conveyed to the Trust include: (1) a 75% net overriding royalty carved out of Southland Royalty Company's fee mineral interests in the Waddell Ranch in Crane County, Texas (the Waddell Ranch properties ); and (2) a 95% net overriding royalty carved out of Southland Royalty Company's major producing royalty interests in Texas (the Texas Royalty properties ). The net overriding royalty for the Texas Royalty properties is subject to the provisions of the lease agreements under which such royalties were created. The financial statements of the Trust are prepared on the following basis:

Royalty income recorded for a month is the amount computed and paid to Bank of America, N.A. ( Trustee ) as Trustee for the Trust by the interest owners: Burlington Resources Oil & Gas Company LP ( BROG ), a subsidiary of ConocoPhillips for the Waddell Ranch properties and Riverhill Energy Corporation ( Riverhill Energy ), formerly a wholly owned subsidiary of Riverhill Capital Corporation ( Riverhill Capital ) and formerly an affiliate of Coastal Management Corporation ( CMC ), for the Texas Royalty properties. Schlumberger Technology Corporation ( STC ) currently conducts all field, technical and accounting operations on behalf of BROG with regard to the Waddell Ranch properties. Riverhill Energy currently conducts the accounting operations for the Texas Royalty properties. Royalty income consists of the amounts received by the owners of the interests burdened by the net overriding royalty interests ( Royalties ) from the sale of production less accrued production costs, development and drilling costs, applicable taxes, operating charges, and other costs and deductions multiplied by 75% in the case of the Waddell Ranch properties and 95% in the case of the Texas Royalty properties.

As was previously reported, in February 1997, BROG sold its interest in the Texas Royalty properties to Riverhill Energy.

The Trustee has been advised that in the first quarter of 1998, STC acquired all of the shares of stock of Riverhill Capital. Prior to such acquisition by STC, CMC and Riverhill Energy were wholly-owned subsidiaries of Riverhill Capital. The Trustee has further been advised that in connection with STC's acquisition of Riverhill Capital, the shareholders of Riverhill Capital acquired ownership of all of the shares of stock of Riverhill Energy. Thus, the ownership in the Texas Royalty properties referenced above remained in Riverhill Energy, the stock ownership of which was acquired by the former shareholders of Riverhill Capital.

In 2007 the Bank of America private wealth management group officially became known as U.S. Trust, Bank of America Private Wealth Management. The legal entity that serves as Trustee of the Trust did not change, and references in this Form 10-Q to U.S. Trust, Bank of America Private Wealth Management shall describe the legal entity Bank of America, N.A.

Trust expenses recorded are based on liabilities paid and cash reserves established out of cash received or borrowed funds for liabilities and contingencies.

Distributions to Unit holders are recorded when declared by the Trustee.

Royalty income is computed separately for each of the conveyances under which the Royalties were conveyed to the Trust. If monthly costs exceed revenues for any conveyance ( excess costs ), such excess cannot reduce royalty income from other conveyances, but is carried forward with accrued interest to be recovered from future net proceeds of that conveyance.

The financial statements of the Trust differ from financial statements prepared in accordance with accounting principles generally accepted in the United States of America ( GAAP ) because revenues are not accrued in the month of production and certain cash reserves may be established for contingencies which would not be accrued in financial statements. Amortization of the Royalties calculated on a unit-of-production basis is charged directly to trust corpus. This comprehensive basis of accounting other than GAAP corresponds to the accounting permitted for royalty trusts by the U.S. Securities and Exchange Commission as specified by Staff Accounting Bulletin Topic 12:E, Financial Statements of Royalty Trusts.

#### **New Accounting Pronouncements**

In February 2006, the FASB issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments* an amendment of FASB Statements No. 133 *Accounting for Derivative Instruments* and No. 140 *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. This statement resolves issues addressed in Statement 133 Implementation Issue No. D1, Application of Statement 133 to Beneficial interests in Securitized Financial Assets. This statement is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. The Trust has no financial instruments and accordingly, the adoption of this new Standard did not impact the financial statements of the Trust.

In March 2006, the FASB issued SFAS No. 156, *Accounting for Servicing of Financial Assets* an amendment of FASB Statements No. 140 *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. This statement requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract in certain situations. This statement is effective as of the beginning of an entity's first fiscal year that begins after September 15, 2006. The adoption of this statement did not have an effect on the Trust's financial statements.

In July 2006, the FASB issued FASB Interpretation No. 48 ( FIN 48 ), *Accounting for Uncertainty in Income Taxes*, which clarifies the accounting for uncertainty in income taxes recognized in the financial statements in accordance with SFAS No. 109,



*Accounting for Income Taxes*. FIN 48 is effective for fiscal years beginning after December 15, 2006. The adoption of this statement did not have an effect on the Trust's financial statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. This statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007. The adoption of this statement did not have an effect on the Trust's financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities-Including an amendment of FASB Statement No. 115*. This statement permits entities to choose to measure many financial instruments and certain other items at fair value. This statement is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The adoption of this statement did not have an effect on the Trust's financial statements.

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations*. This statement requires the acquiring entity in a business combination to recognize the full fair value of assets acquired and liabilities assumed in the transaction (whether a full or partial acquisition); establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed; requires expensing of most transaction and restructuring costs; and requires the acquirer to disclose to investors and other users all of the information needed to evaluate and understand the nature and financial effect of the business combination. This statement applies prospectively to business combinations for which the acquisition date is on or after January 1, 2009. The Trustee does not believe that the adoption of this statement will have a material effect on the Trust's financial statements.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements - an amendment of Accounting Research Bulletin No. 51*. This statement requires reporting entities to present noncontrolling (minority) interests as equity (as opposed to as a liability or mezzanine equity) and provides guidance on the accounting for transactions between an entity and noncontrolling interests. This statement applies prospectively as of January 1, 2009, except for the presentation and disclosure requirements which will be applied retrospectively for all periods presented. The Trustee does not believe that the adoption of this statement will have a material effect on the Trust's financial statements.

In March 2008, the FASB issued FASB Statement No. 161, *Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133* (SFAS No. 161), effective for fiscal years and interim periods beginning after November 15, 2008, with early adoption allowed. SFAS No. 161 amends and expands the disclosure requirements of SFAS No. 133 with the intent to provide users of financial statements with an enhanced understanding of an entity's use of derivative instruments and the effect of those derivative instruments on an entity's financial statements. The Trustee does not believe that the adoption of this statement will have a material effect on the Trust's financial statements.

In May 2008, the FASB issued Statement No. 162, *The Hierarchy of Generally Accepted Accounting Principles*. This statement identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements in conformity with GAAP, and is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board Auditing amendments to AU Section 411, *The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles*. The Trustee does not believe that the adoption of this statement will have a material effect on the Trust's financial statements.

In May 2008, the FASB issued No. 163, *Accounting for Financial Guarantee Insurance Contracts an interpretation of FASB Statement No. 60*. This statement clarifies how SFAS 60 applies to financial guarantee insurance contracts issued by insurance enterprises, including the methodology to account for premium revenue and claim liabilities. The statement is effective for financial statements issued for fiscal years beginning after December 15, 2008. The Trustee does not believe that the adoption of this statement will have a material effect on the Trust's financial statements.

## 2. FEDERAL INCOME TAXES

For Federal income tax purposes, the Trust constitutes a fixed investment trust which is taxed as a grantor trust. A grantor trust is not subject to tax at the trust level. The Unit holders are considered to own the Trust's income and principal as though no trust were in existence. The income of the Trust is deemed to have been received or accrued by each Unit holder at the time such income is received or accrued by the Trust and not when distributed by the Trust.

The Royalties constitute economic interests in oil and gas properties for Federal income tax purposes. Unit holders must report their share of the revenues from the Royalties as ordinary income from oil and gas royalties and are entitled to claim depletion with respect to such income.

The Trust has on file technical advice memoranda confirming the tax treatment described above.

The classification of the Trust's income for purposes of the passive loss rules may be important to a Unit holder. Royalty income generally is treated as portfolio income and does not offset passive losses.

Some Trust Units are held by middlemen, 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 widely held fixed investment trust ( WHFIT ) for U.S. Federal income tax purposes. U.S. Trust, Bank of America Private Wealth Management, 901 Main Street, 17th Floor, Dallas, Texas 75202, telephone number (214) 209-2400, 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. Notwithstanding the foregoing, the middlemen holding Trust Units on behalf of Unit holders, and not the Trustee of the Trust, are solely responsible for complying with the information reporting requirements under the Treasury Regulations with respect to such Trust Units, including the issuance of IRS Forms 1099 and certain written tax statements. Unit holders whose Trust Units are held by middlemen should consult with such middlemen regarding the information that will be reported to them by the middlemen with respect to the Trust Units.

Unit holders should consult their tax advisors regarding Trust tax compliance matters.

### **3. STATE TAX CONSIDERATIONS**

All revenues from the Trust are from sources within Texas, which has no individual income tax. However, effective January 1, 2008, Texas imposes a margin tax at a rate of 1% on gross revenues less certain deductions as specifically set forth in the Texas margin tax statute. The tax generally will be imposed on gross revenues generated in 2007 and thereafter. Entities subject to tax generally include trusts unless otherwise exempt and most other types of entities that provide limited liability protection. Trusts that meet certain statutory requirements are generally exempt from the margin tax as passive entities. The Trust should be exempt from margin tax as a passive entity. Accordingly, each Unit holder that is a business entity subject to the margin tax will generally include its share of the Trust's revenues in its own margin tax computation. The source of such income to a Unit holder would be Texas since the Trust's day-to-day operations are conducted in Texas.

Each Unit holder is urged to consult his own tax advisor regarding the requirements for filing state tax returns.

### **4. SUBSEQUENT EVENTS**

Subsequent to September 30, 2008, the Trust declared a distribution on October 21, 2008 of \$.230874 per unit payable on November 17, 2008, to Unit holders of record on October 31, 2008.

#### **Item 2. Trustee's Discussion and Analysis**

##### **Forward Looking Information**

Certain information included in this report contains, and other materials filed or to be filed by the Trust with the Securities and Exchange Commission (as well as information included in oral statements or other written statements made or to be made by the Trust) may contain or include, forward looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, and Section 27A of the Securities Act of 1933, as amended. Such forward looking statements may be or may concern, among other things, capital expenditures, drilling activity, development activities, production efforts and volumes, hydrocarbon prices and the results thereof, and regulatory matters. Although the Trustee believes that the expectations reflected in such forward-looking statements are reasonable, such expectations are subject

to numerous risks and uncertainties and the Trustee can give no assurance that they will prove correct. There are many factors, none of which is within the Trustee's control, that may cause such expectations not to be realized, including, among other things, factors such as actual oil and gas prices and the recoverability of reserves, capital expenditures, general economic conditions, actions and policies of petroleum-producing nations and other changes in the domestic and international energy markets. Such forward looking statements generally are accompanied by words such as estimate, expect, predict, anticipate, goal, should, assume, believe, or other words that convey the uncertainty of events or outcomes.

**Three Months Ended September 30, 2008 Compared to Three Months Ended September 30, 2007**

For the quarter ended September 30, 2008 royalty income received by the Trust amounted to \$35,552,084 compared to royalty income of \$18,000,323 during the third quarter of 2007. The increase in royalty income is primarily attributable to substantial increases in both oil and gas prices but offset by decreased oil and gas production.

Interest income for the quarter ended September 30, 2008, was \$20,118 compared to \$28,609 during the third quarter of 2007. The decrease in interest income is primarily attributable to lower interest rates. General and administrative expenses during the third quarter of 2008 amounted to \$134,748 compared to \$99,342 during the third quarter of 2007. The increase in general and administrative expenses can be primarily attributed to the timing of payment of expenses.

These transactions resulted in distributable income for the quarter ended September 30, 2008 of \$35,437,454 or \$.760317 per Unit of beneficial interest. Distributions of \$.234609, \$.278952 and \$.246754 per Unit were made to Unit holders of record as of July 31, 2008, August 31, 2008 and September 28, 2008, respectively. For the third quarter of 2007, distributable income was \$17,929,590, or \$.384683 per Unit of beneficial interest.

Royalty income for the Trust for the third quarter of the calendar year is associated with actual oil and gas production for the period of May, June and July 2007 from the product sales from which the Trust's net overriding royalty interests (Royalties) were carved. Oil and gas sales attributable to the Royalties and the properties from which the Royalties were carved are as follows:

|                   | Third Quarter |         |
|-------------------|---------------|---------|
|                   | 2008          | 2007    |
| <b>Royalties:</b> |               |         |
| Oil sales (Bbls)  | 189,184       | 188,507 |
| Gas sales (Mcf)   | 955,832       | 901,602 |

**Product Sales From Which The Royalties Were Carved:**

|                        |           |          |
|------------------------|-----------|----------|
| <b>Oil:</b>            |           |          |
| Total oil sales (Bbls) | 265,967   | 294,548  |
| Average per day (Bbls) | 2,891     | 3,202    |
| Average price per Bbl  | \$ 104.07 | \$ 61.78 |

|                       |           |           |
|-----------------------|-----------|-----------|
| <b>Gas:</b>           |           |           |
| Total gas sales (Mcf) | 1,475,516 | 1,611,556 |
| Average per day (Mcf) | 16,038    | 17,517    |
| Average price per Mcf | \$ 11.06  | \$ 8.02   |

The average received price of oil increased to an average price per barrel of \$104.07 per Bbl in the third quarter of 2008, compared to \$61.78 per Bbl in the third quarter of 2007. The Trustee has been advised by ConocoPhillips that for the period of August 1, 1993, through September 30, 2008, the oil from the Waddell Ranch properties was being sold under a competitive bid to a third party. The average price of gas increased from \$8.02 per Mcf in the third quarter of 2007 to \$11.06 per Mcf in the third quarter of 2008 due to change in overall market variables.

Since the oil and gas sales attributable to the Royalties are based on an allocation formula that is dependent on such factors as price and cost (including capital expenditures), the production amounts in the Royalties section of the above table do not provide a meaningful comparison. Oil and gas sales volumes from the Underlying Properties (as defined in the Trust's Annual Report on Form 10-K for the year ended December 31, 2007) decreased for the applicable period in 2008 compared to 2007.

Capital expenditures for drilling, remedial and maintenance activities on the Waddell Ranch properties during the third quarter of 2008 totaled \$2,643,259 as compared to \$2,936,440 for the third quarter of 2007. ConocoPhillips has informed the Trustee that the 2008 capital expenditures budget has been revised to \$31.0 million for the Waddell Ranch properties. The total amount of capital expenditures for 2007 was \$11.2 million. Through the third quarter of 2008, capital expenditures of \$4.3 million have been expended.

The Trustee has been advised that there were no wells completed and 4 drill wells in progress, and 21 workover wells completed and 14 workover wells in progress, during the three months ended September 30, 2008 as compared to no wells completed, 1 drill well in progress, no

workover wells completed and 1 workover well in progress for the three months ended September 30, 2007 on the Waddell Ranch properties. There were 3 facility projects completed and no projects in progress for the third quarter of 2008.

Lease operating expense and property taxes totaled \$4.2 million for the third quarter of 2008, compared to \$3.6 million in the third quarter of 2007 on the Waddell Ranch properties. This increase is primarily attributable to increased electrical costs and increased ad valorem taxes paid for the third quarter in 2008.

#### **Nine Months Ended September 30, 2008 and 2007**

For the nine months ended September 30, 2008, royalty income received by the Trust amounted to \$89,237,008 compared to royalty income of \$45,320,284 for the nine months ended September 30, 2007. The increase in royalty income is primarily due to a substantial increase in oil and gas prices in the first nine months of 2008 compared to the first nine months in 2007. Interest income for the nine months ended September 30, 2008 was \$75,332 compared to \$86,602 for the nine months ended September 30, 2007. The increase in interest income is attributable primarily to more funds available for investment. General and administrative expenses for the nine months ended September 30, 2008 were \$848,993. During the nine months ended September 30, 2007, general and administrative expenses were \$743,962. The increase in general and administrative expenses is primarily due to enhanced Unit holder tax reporting to more Unit holders.

These transactions resulted in distributable income for the nine months ended September 30, 2008 of \$88,463,347, or \$1.89797 per Unit. For the nine months ended September 30, 2007, distributable income was \$44,662,924, or \$.958251 per Unit.

Royalty income for the Trust for the period ended September 30, 2008 is associated with actual oil and gas production for the period November 2007 through July 2008 from the properties from which the Royalties were carved. Oil and gas production attributable to the Royalties and the properties from which the Royalties were carved are as follows:

|   | <b>First Nine Months</b> |             |
|---|--------------------------|-------------|
|   | <b>2008</b>              | <b>2007</b> |
| <b>Royalties:</b>                                       |                          |             |
| Oil sales (Bbls)  | 588,229                  | 524,564     |
| Gas sales (Mcf)   | 2,921,475                | 2,411,577   |
| <b>Properties From Which The Royalties Were Carved:</b> |                          |             |
| Oil:  |                          |             |
| Total oil sales (Bbls)                                  | 823,874                  | 881,724     |
| Average per day (Bbls)                                  | 3,007                    | 3,230       |
| Average price per Bbl                                   | \$ 104.07                | \$ 56.41    |
| Gas:  |                          |             |
| Total gas sales (Mcf)                                   | 4,488,904                | 4,763,647   |
| Average per day (Mcf)                                   | 16,383                   | 17,449      |
| Average price per Mcf                                   | \$ 11.06                 | \$ 7.31     |

The average price of oil increased during the nine months ended September 30, 2008 to \$104.07 per barrel compared to \$56.41 per barrel for the same period in 2007. The increase in the average price of oil is primarily due to increased demand in 2008, caused by a worldwide market conditions. The increase in the average price of gas from \$7.31 per Mcf for the nine months ended September 30, 2007 to \$11.06 per Mcf for the nine months ended September 30, 2008 is primarily the result of an increase in the spot prices of natural gas.

Since the oil and gas sales volumes attributable to the Royalties are based on an allocation formula that is dependent on such factors as price and cost (including capital expenditures), the production amounts in the Royalties section of the above table do not provide a meaningful comparison. The oil and gas sales volumes from the properties from which the Royalties are carved have decreased slightly for the applicable period of 2008 compared to 2007. Capital expenditures for the Waddell Ranch properties for the nine months ended September 30, 2008 totaled \$4.3 million compared to \$11.5 million for the same period in 2007. ConocoPhillips has previously advised the Trust that the remaining 2008 capital expenditures budget for the Waddell Ranch properties is \$11.7 million. The Trust has been advised that 0 wells were drilled and completed and 4 wells to be completed on the Waddell Ranch properties during the nine months ended September 30, 2008, as compared to 13 wells drilled and completed and only 1 well to be completed on the Waddell Ranch Properties during the nine months ended September 30, 2007. Approximately 29 workover wells were completed and approximately 14 workover wells were in progress as of September 30, 2008. Approximately 3 facilities projects were completed and no facilities projects were in progress. Lease operating expense and property taxes totaled \$12.2 million for the nine months ended September 30, 2008 compared to \$11.2 million for the same period in 2007. The increase in lease operating expense is primarily attributable to higher electrical costs than in 2007 and increased property taxes.

#### **Calculation of Royalty Income**

The Trust's royalty income is computed as a percentage of the net profit from the operation of the properties in which the Trust owns net overriding royalty interests. These percentages of net profits are 75% and 95% in the case of the Waddell Ranch properties and the Texas Royalty properties, respectively. Royalty income received by the Trust for the three months ended September 30, 2008 and 2007, respectively, were computed as shown in the table below:

|  | <b>THREE MONTHS ENDED SEPTEMBER 30,</b> |   |   |   |
|--|---|---|---|---|
|  | <b>2008</b>                             |   | <b>2007</b>                             |   |
|  | <b>WADDELL<br/>RANCH<br/>PROPERTIES</b> | <b>TEXAS<br/>ROYALTY<br/>PROPERTIES</b> | <b>WADDELL<br/>RANCH<br/>PROPERTIES</b> | <b>TEXAS<br/>ROYALTY<br/>PROPERTIES</b> |
| Gross proceeds of sales from the Underlying Properties |   |   |   |   |
| Oil proceeds   | \$ 23,642,563                           | \$ 10,349,023                           | \$ 12,973,597                           | \$ 5,222,568                            |
| Gas proceeds   | 17,463,110                              | 2,570,597                               | 11,539,620                              | 1,386,647                               |

|   | <b>THREE MONTHS ENDED SEPTEMBER 30,</b> |   |   |   |
|---|---|---|---|---|
|   | <b>2008</b>                             |   | <b>2007</b>                             |   |
|   | <b>WADDELL<br/>RANCH<br/>PROPERTIES</b> | <b>TEXAS<br/>ROYALTY<br/>PROPERTIES</b> | <b>WADDELL<br/>RANCH<br/>PROPERTIES</b> | <b>TEXAS<br/>ROYALTY<br/>PROPERTIES</b> |
| Total                                     | 41,105,673                              | 12,919,620                              | 24,513,217                              | 6,609,215                               |
| Less:                                     |   |   |   |   |
| Severance tax:                            |   |   |   |   |
| Oil                                       | 1,006,313                               | 386,307                                 | 563,061                                 | 198,641                                 |
| Gas                                       | 1,061,080                               | 162,598                                 | 859,692                                 | 90,839                                  |
| Lease operating expense and property tax: |   |   |   |   |
| Oil and gas                               | 4,243,815                               | 330,000                                 | 3,740,591                               | 330,000                                 |
| Capital expenditures                      | 2,643,259                               |   | 2,936,440                               |   |
| Total                                     | 8,954,467                               | 878,905                                 | 8,099,784                               | 619,480                                 |
| Net profits                               | 32,151,206                              | 12,040,715                              | 16,413,433                              | 5,989,735                               |
| Net overriding royalty interests          | 75%                                     | 95%                                     | 75%                                     | 95%                                     |
| Royalty income                            | \$ 24,113,405                           | \$ 11,438,679                           | \$ 12,310,075                           | \$ 5,690,248                            |

### **Critical Accounting Policies and Estimates**

The Trust's financial statements reflect the selection and application of accounting policies that require the Trust to make significant estimates and assumptions. The following are some of the more critical judgment areas in the application of accounting policies that currently affect the Trust's financial condition and results of operations.

#### *Basis of Accounting*

The financial statements of the Trust are prepared on a modified cash basis and are not intended to present financial positions and results of operations in conformity with accounting principles generally accepted in the United States of America (GAAP). Preparation of the Trust's financial statements on such basis includes the following:

Royalty income and interest income are recorded in the period in which amounts are received by the Trust rather than in the period of production and accrual, respectively.

General and administrative expenses recorded are based on liabilities paid and cash reserves established out of cash received.

Amortization of the royalty interests is calculated on a unit-of-production basis and charged directly to trust corpus when revenues are received.

Distributions to Unit holders are recorded when declared by the Trustee (see Note 1 to the Financial Statements).



The financial statements of the Trust differ from financial statements prepared in accordance with accounting principles generally accepted in the United States of America because royalty income is not accrued in the period of production, general and administrative expenses recorded are based on liabilities paid and cash reserves established rather than on accrual basis, and amortization of the royalty interests is not charged against operating results. This comprehensive basis of accounting other than GAAP corresponds to the accounting permitted for royalty trusts by the U.S. Securities and Exchange Commission as specified by Staff Accounting Bulletin Topic 12:E, Financial Statements of Royalty Trusts.

*New Accounting Pronouncements*

In February 2006, the FASB issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments* an amendment of FASB Statements No. 133 *Accounting for Derivative Instruments* and No. 140 *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. This statement resolves issues addressed in Statement 133 Implementation Issue No. D1, Application of Statement 133 to Beneficial interests in Securitized Financial Assets. This statement is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. The Trust has no financial instruments and accordingly, the adoption of this new Standard did not impact the financial statements of the Trust.

In March 2006, the FASB issued SFAS No. 156, *Accounting for Servicing of Financial Assets* an amendment of FASB Statements No. 140 *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. This statement requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract in certain situations. This statement is effective as of the beginning of an entity's first fiscal year that begins after September 15, 2006. The adoption of this statement did not have an effect on the Trust's financial statements.

In July 2006, the FASB issued FASB Interpretation No. 48 ( FIN 48 ), *Accounting for Uncertainty in Income Taxes*, which clarifies the accounting for uncertainty in income taxes recognized in the financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*. FIN 48 is effective for fiscal years beginning after December 15, 2006. The adoption of this statement did not have an effect on the Trust's financial statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. This statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007. The adoption of this statement did not have an effect on the Trust's financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities-Including an amendment of FASB Statement No. 115*. This statement permits entities to choose to measure many financial instruments and certain other items at fair value. This statement is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The adoption of this statement did not have an effect on the Trust's financial statements.

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations*. This statement requires the acquiring entity in a business combination to recognize the full fair value of assets acquired and liabilities assumed in the transaction (whether a full or partial acquisition); establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed; requires expensing of most transaction and restructuring costs; and requires the acquirer to disclose to investors and other users all of the information needed to evaluate and understand the nature and financial effect of the business combination. This statement applies prospectively to business combinations for which the acquisition date is on or after January 1, 2009. The Trustee does not believe that the adoption of this statement will have a material effect on the Trust's financial statements.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment of Accounting Research Bulletin No. 51*. This statement requires reporting entities to present noncontrolling (minority) interests as equity (as opposed to as a liability or mezzanine equity) and provides guidance on the accounting for transactions between an entity and noncontrolling interests. This statement applies prospectively as of January 1, 2009, except for the presentation and disclosure requirements which will be applied retrospectively for all periods presented. The Trustee does not believe that the adoption of this statement will have a material effect on the Trust's financial statements.

In March 2008, the FASB issued FASB Statement No. 161, *Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133* (SFAS No. 161), effective for fiscal years and interim periods beginning after November 15, 2008, with early adoption allowed. SFAS No. 161 amends and expands the disclosure requirements of SFAS No. 133 with the intent to provide users of financial statements with an enhanced understanding of an entity's use of derivative instruments and the effect of those derivative instruments on an entity's financial statements. The Trustee does not believe that the adoption of this statement will have a material effect on the Trust's financial statements.

In May 2008, the FASB issued Statement No. 162, *The Hierarchy of Generally Accepted Accounting Principles*. This statement identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements in conformity with GAAP, and is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board Auditing amendments to AU Section 411, *The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles*. The Trustee does not believe that the adoption of this statement will have a material effect on the Trust's financial statements.

In May 2008, the FASB issued No. 163, *Accounting for Financial Guarantee Insurance Contracts an interpretation of FASB Statement No. 60*. This statement clarifies how SFAS 60 applies to financial guarantee insurance contracts issued by insurance enterprises, including the methodology to account for premium revenue and claim liabilities. The statement is effective for financial statements issued for fiscal years beginning after December 15, 2008. The Trustee does not believe that the adoption of this statement will have a material effect on the Trust's financial statements.

*Revenue Recognition*

Revenues from the royalty interests are recognized in the period in which amounts are received by the Trust. Royalty income received by the Trust in a given calendar year will generally reflect the proceeds, on an entitlement basis, from natural gas produced and sold for the twelve-month period ended October 31st in that calendar year. Royalty income received by the Trust in the third quarter of 2008 generally reflects the proceeds associated with actual oil and gas production for the period of May, June and July 2008.

*Reserve Disclosure*

As of January 1, 2008, independent petroleum engineers estimated the net proved reserves attributable to the royalty interests. In accordance with Statement of Financial Standards No. 69, Disclosures About Oil and Gas Producing Activities, estimates of future net revenues from proved reserves have been prepared using year-end contractual gas prices and related costs. Numerous uncertainties are inherent in estimating volumes and the value of proved reserves and in projecting future production rates and the timing of development of non-producing reserves. Such reserve estimates are subject to change as additional information becomes available. The reserves actually recovered and the timing of production may be substantially different from the reserves estimates.

*Contingencies*

Contingencies related to the Underlying Properties that are unfavorably resolved would generally be reflected by the Trust as reductions to future royalty income payments to the Trust with corresponding reductions to cash distributions to Unit holders. The Trustee is aware of no such items as of September 30, 2008.

*Use of Estimates*

The preparation of financial statements in conformity with the basis of accounting described above requires management to make estimates and assumptions that affect the reported amounts of certain assets, liabilities, revenues and expenses as of and for the reporting period. Actual results may differ from such estimates.

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

There have been no material changes in the Trust's market risk, as disclosed in the Trust's Annual Report on Form 10-K for the fiscal year ended December 31, 2007.

**Item 4. Controls and Procedures**

As of the end of the period covered by this report, the Trustee carried out an evaluation of the effectiveness of the design and operation of the Trust's disclosure controls and procedures pursuant to Exchange Act Rules 13a-15 and 15d-15. Based upon that evaluation, the Trustee concluded that the Trust's disclosure control and procedures are effective in timely alerting the Trustee to material information relating to the Trust required to be included in the Trust's periodic filings with the Securities and Exchange Commission. In its evaluation of disclosure

controls and procedures, the Trustee has relied, to the extent considered reasonable, on information provided by Burlington Resources Oil & Gas Company LP, the owner of the Waddell Ranch properties, and Riverhill Energy Corporation, the owner of the Texas Royalty properties. There has not been any change in the Trust's internal control over financial reporting during the period covered by this report that has materially affected, or is reasonably likely to materially affect, the Trust's internal control over financial reporting.

**PART II OTHER INFORMATION**

**Items 1 through 5.**

Not applicable.

**Item 6. Exhibits**

- 4.1 Permian Basin Royalty Trust Indenture dated November 3, 1980, between Southland Royalty Company (now Burlington Resources Oil & Gas Company LP) and The First National Bank of Fort Worth (now Bank of America, N.A.), as Trustee, heretofore filed as Exhibit (4)(a) to the Trust's Annual Report on Form 10-K to the Securities and Exchange Commission for the fiscal year ended December 31, 1980 is incorporated herein by reference.
- 4.2 Net Overriding Royalty Conveyance (Permian Basin Royalty Trust) from Southland Royalty Company (now Burlington Resources Oil & Gas Company LP) to The First National Bank of Fort Worth (now Bank of America, N.A.), as Trustee, dated November 3, 1980 (without Schedules), heretofore filed as Exhibit (4)(b) to the Trust's Annual Report on Form 10-K to the Securities and Exchange Commission for the fiscal year ended December 31, 1980 is incorporated herein by reference.
- 4.3 Net Overriding Royalty Conveyance (Permian Basin Royalty Trust - Waddell Ranch) from Southland Royalty Company (now Burlington Resources Oil & Gas Company LP) to The First National Bank of Fort Worth (now Bank of America, N.A.), as Trustee, dated November 3, 1980 (without Schedules), heretofore filed as Exhibit (4)(c) to the Trust's Annual Report on Form 10-K to the Securities and Exchange Commission for the fiscal year ended December 31, 1980 is incorporated herein by reference.
- 10.1 Registration Rights Agreement dated as of July 21, 2004 by and between Burlington Resources, Inc. and Bank of America, N.A., as trustee of Permian Basin Royalty Trust, heretofore filed as Exhibit 10.1 to the Trust's Quarterly Report on Form 10-Q to the Securities and Exchange Commission for the quarterly period ended June 30, 2004 is incorporated herein by reference.
- 10.2 Underwriting Agreement dated December 15, 2005 among the Permian Basin Royalty Trust, Burlington Resources, Inc., Burlington Resources Oil & Gas L.P. and Lehman Brothers Inc. and Wachovia Capital Markets, LLC as representatives of the several underwriters, heretofore filed as Exhibit 10.1 to the Trust's current report on Form 8-K to the Securities and Exchange Commission filed on December 19, 2005 is incorporated herein by reference.

- 10.3 Underwriting Agreement dated August 2, 2005 among the Permian Basin Royalty Trust, Burlington Resources, Inc., Burlington Resources Oil & Gas L.P. and Goldman Sachs & Co. and Lehman Brothers Inc. as representatives of the several underwriters, heretofore filed as Exhibit 10.1 to the Trust's current report on Form 8-K to the Securities and Exchange Commission filed on August 8, 2005, is incorporated herein by reference.
- 10.4 Underwriting Agreement dated August 17, 2006, among Permian Basin Royalty Trust, ConocoPhillips, Burlington Resources Oil & Gas Company LP and Lehman Brothers Inc. and Wachovia Capital Markets, LLC as representatives of the several underwriters heretofore filed as Exhibit 10.1 to the Trust's current report on Form 8-K to the Securities and Exchange Commission filed on August 22, 2006, is incorporated herein by reference.
- 31.1 Certification by Ron E. Hooper, Senior Vice President and Trust Administrator of Bank of America, Trustee of Permian Basin Royalty Trust, dated November 7, 2008 and submitted pursuant to Rule 13a-14(a)/15d-14(a) and pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certificate by Bank of America, Trustee of Permian Basin Royalty Trust, dated November 7, 2008 and submitted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350).

**SIGNATURES**

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

BANK OF AMERICA, N.A.,  
TRUSTEE FOR THE  
PERMIAN BASIN ROYALTY TRUST

By: /s/ RON E. HOOPER

Ron E. Hooper,  
Senior Vice President and Trust  
Administrator  
Bank of America, N.A.

Date: November 7, 2008

(The Trust has no directors or executive officers.)

**INDEX TO EXHIBITS**

| Exhibit<br>Number | Exhibit   |
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- 32.1 Certificate by Bank of America, Trustee of Permian Basin Royalty Trust, dated November 7, 2008 and submitted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350).

\* A copy of this Exhibit is available to any Unit holder, at the actual cost of reproduction, upon written request to the Trustee, U.S. Trust, Bank of America Private Wealth Management, 901 Main Street, Dallas, Texas 75202.