

MESA ROYALTY TRUST/TX  
Form 10-Q  
November 09, 2012

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**UNITED STATES**  
**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 September 30, 2012

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 ý No o

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 and posted 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 November 9, 2012 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 September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Royalty income	\$ 737,229	\$ 2,081,025	\$ 2,926,291	\$ 5,023,799
Interest income	80,040	54	80,137	78
General and administrative expense	(128,460)	(28,841)	(235,424)	(118,231)
Distributable income	\$ 688,809	\$ 2,052,238	\$ 2,771,004	\$ 4,905,646
Distributable income per unit	\$ .3696	\$ .9671	\$ 1.4869	\$ 2.2299
Units outstanding	1,863,590	1,863,590	1,863,590	1,863,590

## STATEMENTS OF ASSETS, LIABILITIES AND TRUST CORPUS

	September 30, 2012	December 31, 2011
	(Unaudited)	
<b>ASSETS</b>		
Cash and short-term investments	\$ 1,688,809	\$ 2,351,895
Net overriding royalty interest in oil and gas properties	42,498,034	42,498,034
Accumulated amortization	(37,796,348)	(37,411,336)
Total assets	\$ 6,390,495	\$ 7,438,593
<b>LIABILITIES AND TRUST CORPUS</b>		
Distributions payable	\$ 688,809	\$ 1,351,895
Trust corpus (1,863,590 units of beneficial interest authorized, issued and outstanding)	5,701,686	6,086,698
Total liabilities and trust corpus	\$ 6,390,495	\$ 7,438,593

(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 September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
Trust corpus, beginning of period	\$ 5,821,564	\$ 5,867,600	\$ 6,086,698	\$ 5,557,747
Distributable income	688,809	2,052,238	2,771,004	4,905,646
Distributions to unitholders	(688,809)	(1,802,238)	(2,771,004)	(4,155,646)
Amortization of net overriding royalty interest	(119,878)	(118,107)	(385,012)	(308,254)
Trust corpus, end of period	\$ 5,701,686	\$ 5,999,493	\$ 5,701,686	\$ 5,999,493

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

**MESA ROYALTY TRUST**

**NOTES TO FINANCIAL STATEMENTS**

**(Unaudited)**

**Note 1 Trust Organization and Provisions**

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 the portion of its interests in the San Juan Basin Royalty Properties located in Colorado to MarkWest Energy Partners, Ltd. (effective January 1, 1993) and Red Willow Production Company (effective April 1, 1992). On October 26, 1994, MarkWest Energy Partners, Ltd. sold substantially all of its interest in the Colorado San Juan Basin Royalty Properties to BP Amoco Company ("BP"), a subsidiary of BP p.l.c. Until August 7, 1997, MESA Inc. operated the Hugoton Royalty Properties through Mesa Operating Co., a wholly owned subsidiary of MESA Inc. On August 7, 1997, MESA Inc. merged with and into Pioneer Natural Resources Company ("Pioneer"), formerly a wholly owned subsidiary of MESA Inc., and Parker & Parsley Petroleum Company merged with and into Pioneer Natural Resources USA, Inc. (successor to Mesa Operating Co.), a wholly owned subsidiary of Pioneer ("PNR") (collectively, the mergers are referred to herein as the "Merger"). Subsequent to the Merger, the Hugoton Royalty Properties have been operated by PNR. Substantially all of the San Juan Basin Royalty Properties located in New Mexico are operated by ConocoPhillips. Effective January 1, 2005, ConocoPhillips assigned its interest in an immaterial number of San Juan Basin Royalty Properties located in New Mexico to XTO Energy Inc. The San Juan Basin Royalty Properties located in Colorado are operated by BP. As used in this report, PNR refers to the operator of the Hugoton Royalty Properties, ConocoPhillips refers to the operator of the San Juan Basin Royalty Properties, other than the portion of such properties located in Colorado, and BP refers to the operator of the Colorado San Juan Basin Royalty Properties unless otherwise indicated.

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

- (a) the Trust cannot engage in any business or investment activity or purchase any assets;
- (b) the Royalty can be sold in part or in total for cash upon approval by the unitholders;
- (c) the Trustee can establish cash reserves and borrow funds to pay liabilities of the Trust and can pledge assets of the Trust to secure payment of the borrowings;
- (d) the Trustee will make cash distributions to the unitholders in January, April, July and October each year as discussed more fully in Note 2;
- (e) the Trust will terminate upon the first to occur of the following events: (i) at such time as the Trust's royalty income for two successive years is less than \$250,000 per year or (ii) a vote by

## MESA ROYALTY TRUST

## NOTES TO FINANCIAL STATEMENTS (Continued)

(Unaudited)

**Note 1 Trust Organization and Provisions (Continued)**

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.

Effective January 1, 2011, the Trustee began withholding \$83,333 of cash per month for future unknown contingent liabilities and expenses in accordance with the Trust Indenture. The cash withholding was established through the withholding of cash received during 2011 of approximately \$83,333 per monthly distribution amount, or up to \$250,000 per quarter, until the cash withholding reached \$1.0 million. At December 31, 2011, the Trust had withheld a total of \$1.0 million which is included in cash and short term investments. The effect on distributable income per unit is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Distributable Income Before Reserve for Contingent Liabilities and Expenses	\$ 688,809	\$ 2,052,238	\$ 2,771,004	\$ 4,905,646
Reserve for Contingent Liabilities and Expenses		(250,000)		(750,000)
Distributable Income Available for Distribution	688,809	1,802,238	2,771,004	4,155,646
Distributable Income Per Unit	\$ .3696	\$ 0.9671	\$ 1.4869	\$ 2.2299
Units Outstanding	1,863,590	1,863,590	1,863,590	1,863,590

**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, 2011. The Trust considers all highly liquid investments with a maturity of three months or less to be cash equivalents. Subsequent events were evaluated through the issuance date of the financial statements.

In accordance with the Conveyance, the Working Interest Owners are obligated to 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

**MESA ROYALTY TRUST**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

**(Unaudited)**

**Note 2 Basis of Presentation (Continued)**

"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.

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

- (a) Royalty income recorded for a month is the amount computed and paid by the Working Interest Owners to the Trustee for such month rather than either the value of a portion of the oil and gas produced by the Working Interest Owners for such month or the amount subsequently determined to be the Trust's proportionate share of the net proceeds for such month;
- (b) Interest income, interest receivable and distributions payable to unitholders include interest to be earned on short-term investments from the financial statement date through the next date of distribution;
- (c) Trust general and administrative expenses, net of reimbursements, are recorded in the month they are included in the calculation of the monthly distribution amount;
- (d) 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; and
- (e) Distributions payable are determined on a monthly basis and are payable to unitholders of record as of the last business day of each month or such later date as the Trustee determines is required to comply with applicable law or stock exchange requirements. However, cash distributions are made quarterly in January, April, July and October, and include interest earned from the monthly record dates to the date of distribution.

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

**Note 3 Legal Proceedings**

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

**MESA ROYALTY TRUST**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

**(Unaudited)**

**Note 4 Income Tax Matters**

In a technical advice memorandum dated February 26, 1982, the IRS advised the Dallas District Director that the Trust is classifiable as a grantor trust and not as an association taxable as a corporation. As a grantor trust, the Trust incurs no federal income tax liability and each unitholder is subject to tax on the unitholder's pro rata share of the income and expense of the Trust as if the unitholder were the direct owner of a pro rata share of the Trust's assets. In addition, there is no state tax liability for the period.

The Trustee assumes that 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 non-mortgage widely held fixed investment trust ("WHFIT") for U.S. federal income tax purposes. The Bank of New York Mellon Trust Company, N.A., 919 Congress Avenue, Austin, Texas 78701, telephone number 1-800-852-1422, is the representative of the Trust that will provide tax information in accordance with applicable U.S. Treasury Regulations governing the information reporting requirements of the Trust as a WHFIT. Notwithstanding the foregoing, the middlemen holding units on behalf of unitholders, 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 units, including the issuance of IRS Forms 1099 and certain written tax statements. Unitholders whose 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 units.

**Note 5 Excess Production Costs**

Excess production costs result when costs, charges, and expenses attributable to a Working Interest Property exceed the revenue received from the sale of oil, gas, and other hydrocarbons produced from such property. The excess production costs must be recovered by the working interest owners before any distribution of Royalty income from the properties will be made to the Trust. As of September 30, 2012 and December 31, 2011, there were no excess production costs on the Trust Properties.

**Note 6 Tax Assessment**

PNR has advised the Trustee that it received a proposed assessment from the Kansas Department of Revenue on September 10, 2009, for additional tax, penalty and interest of approximately \$4.1 million resulting primarily from the settlement of the lawsuit *John Steven Alford and Robert Larrabee, individually and on behalf of a Plaintiff Class v. Pioneer Natural Resources USA, Inc.* in early 2007. The portion of the tax assessment net to the Trust is approximately \$181,000, which could adversely affect Trust distributions. PNR has submitted a written response objecting to the proposed assessment. On March 25, 2010, the Kansas Department of Revenue issued a final assessment, which included additional interest and penalties, increasing the amount assessed to approximately \$4.5 million. The portion of the tax assessment net to the Trust is approximately \$197,000, which could adversely affect Trust distributions. On June 24, 2011, the hearing examiner of the Department of Revenue upheld the earlier assessment. PNR has filed an appeal to the Court of Tax Appeals in Kansas.



**MESA ROYALTY TRUST**

**NOTES TO FINANCIAL STATEMENTS (Continued)**

**(Unaudited)**

**Note 6 Tax Assessment (Continued)**

On December 9, 2011, PNR and the Kansas Department of Revenue entered into a settlement of the Department of Revenue's assessment. The settlement amount was \$2 million, which is less than 50% of the amount of the assessment. As a result of the settlement, the appeal of the assessment pending before the Court of Tax Appeals was dismissed on December 20, 2011. The portion of the tax assessment net to the Trust is \$84,719 and was withheld from cash available for distribution in January 2012.

**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 9 to the financial statements in the Trust's Annual Report on Form 10-K for the year ended December 31, 2011. 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 to be 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, 2011, including under "Item 1A. Risk Factors". All subsequent written and oral forward-looking statements attributable to the Trust or persons acting on its behalf are expressly qualified in their entirety by the Cautionary Statements.

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

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

	Three Months Ended September 30,			
	2012		2011	
	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)	\$ 703,097	\$ 761,245	\$ 1,423,304	\$ 1,378,356
Less the Trust's proportionate share of:				
Capital costs recovered	(49,212)	(74,298)	(38,214)	(51,981)
Operating costs	(302,396)	(301,207)	(293,112)	(337,328)
<b>Net Proceeds</b>	<b>\$ 351,489</b>	<b>\$ 385,740</b>	<b>1,091,978</b>	<b>989,047</b>
Royalty income	\$ 351,489	\$ 385,740	1,091,978	989,047
<b>Average sales price</b>	<b>\$ 1.91</b>	<b>\$ 27.19</b>	<b>\$ 3.66</b>	<b>\$ 42.84</b>
<b>Average production costs(3)</b>	<b>\$ 1.91</b>	<b>\$ 26.47</b>	<b>\$ 1.11</b>	<b>\$ 16.86</b>
	<b>(Mcf)</b>	<b>(Bbls)</b>	<b>(Mcf)</b>	<b>(Bbls)</b>
Net production volumes attributable to the Royalty paid(4)	184,305	14,186	298,078	23,087

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	Nine Months Ended September 30,			
	2012		2011	
	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)	\$ 2,522,633	\$ 2,999,637	\$ 3,970,313	\$ 3,474,419
Less the Trust's proportionate share of:				
Capital costs recovered	(195,668)	(422,693)	(193,975)	(191,230)
Operating costs	(925,595)	(1,052,023)	(1,053,843)	(922,440)
<b>Net Proceeds</b>	<b>1,401,370</b>	<b>1,524,921</b>	<b>2,722,495</b>	<b>2,360,749</b>
Royalty income(2)	1,401,370	1,524,921	2,722,495	2,360,749
Average sales price	\$ 2.30	\$ 33.32	\$ 3.44	\$ 40.25
Average production costs(3)	\$ 1.84	\$ 32.23	\$ 1.57	\$ 18.99
	<b>(Mcf)</b>	<b>(Bbls)</b>	<b>(Mcf)</b>	<b>(Bbls)</b>
Net production volumes attributable to the Royalty paid(4)	607,975	45,760	792,325	58,656

- (1) Gross Proceeds from natural gas liquids attributable to the Hugoton and San Juan Basin Properties are net of a volumetric in-kind processing fee retained by PNR and ConocoPhillips, respectively.
- (2) Due to an adjustment of \$60,000 to royalty income at December 31, 2010, the natural gas royalty income and oil condensate and natural gas liquids royalty income may not agree to the nine months ended September 30, 2011 royalty income.
- (3) Average production costs attributable to the Trust are calculated as stated capital costs plus operating costs, divided by stated net production volumes attributable to the Royalty paid. Production costs may be incurred in one operating period and then recovered in a subsequent operating period, which may cause Royalty income paid to the Trust not to agree to the Trust's Royalty interest in the Net Proceeds.
- (4) Net production volumes attributable to the Trust are determined by dividing Royalty income by the average sales price received.

**Three Months Ended September 30, 2012 and 2011**

*Financial Review*

	Three Months Ended September 30,	
	2012	2011
Royalty income	\$ 737,229	\$ 2,081,025
Interest income	80,040	54
General and administrative expense	(128,460)	(28,841)
Distributable income	\$ 688,809	\$ 2,052,238

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Distributable income per unit	\$	.3696	\$	.9671
Units outstanding		1,863,590		1,863,590

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The Trust's Royalty income was \$737,229 in the third quarter of 2012, a decrease of approximately 65% as compared to \$2,081,025 in the third quarter of 2011, primarily as a result of lower natural gas and natural gas liquids prices and lower natural gas and natural gas liquids volumes in the third quarter of 2012 as compared to the third quarter of 2011. The Trust's Interest income in the third quarter of 2012 was \$80,040, an increase from \$54 in the third quarter of 2011. In accordance with the Trust Indenture, interest on cash on hand was paid at a rate of 1.5% below the prime interest rate. In addition, General and administrative expense increased to \$128,460 for the three months ended September 30, 2012, compared to \$118,231 for the three months ended September 30, 2011. The increase was a result of Trust administrative expenses incurred in the third quarter of 2012 that are expected to be reimbursed in accordance with the Trust Indenture in the fourth quarter of 2012.

The distributable income of the Trust for each period includes the Royalty income received from the working interest owners during such period, plus interest income earned to the date of distribution (if any). Trust administration expenses are deducted in the computation of distributable income. Distributable income for the quarter ended September 30, 2012 was \$688,809, representing \$.3696 per unit, compared to \$2,052,238, representing \$.9671 per unit, for the quarter ended September 30, 2011 after the withholding of cash for future unknown contingent and expenses. Based on 1,863,590 units outstanding for the quarters ended September 30, 2012 and 2011, respectively, the per unit distributions were as follows:

	2012	2011
July	\$ .1154	\$ .3318
August	.1033	.3277
September	.1509	.3076
	\$ .3696	\$ .9671

Effective January 1, 2011, the Trustee began withholding \$83,333 of cash per month for future unknown contingent liabilities and expenses in accordance with the Trust Indenture. The cash withholding was established through the withholding of cash received during 2011 of approximately \$83,333 per monthly distribution amount, or up to \$250,000 per quarter, until the cash withholding reached \$1.0 million. At September 30, 2011 and December 31, 2011, the Trust had withheld a total of \$750,000 and \$1.0 million, respectively, which is included in cash and short-term investments. The effect on distributable income per unit is as follows:

	Three Months Ended September 30,	
	2012	2011
Distributable Income Before Reserve for Contingent Liabilities and Expenses	\$ 688,809	\$ 2,052,238
Reserve for Contingent Liabilities and Expenses (See Note 1)		(250,000)
Distributable Income Available for Distribution	688,809	1,802,238
Distributable Income Per Unit	\$ .3696	\$ 0.9671
Units Outstanding	1,863,590	1,863,590

*Operational Review*

*Hugoton Field*

Natural gas and natural gas liquids production attributable to the Trust from the Hugoton field accounted for approximately 34% of the Royalty income of the Trust during the third quarter of 2012.

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. During 2012 to date and 2011 the primary purchaser was Oneok Gas Marketing, Inc. PNR has advised the Trust that it expects to continue to market gas production from the Hugoton field under short-term and multi-month contracts. As discussed below, overall market prices received for natural gas from the Hugoton Royalty Properties were lower in the third quarter of 2012 compared to the third quarter of 2011.

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 beginning effective June 1, 2001. The contract is renewed a year in advance, so PNR extended the contract to June 1, 2013. 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.

Royalty income attributable to the Hugoton Royalty decreased to \$249,808 in the third quarter of 2012 from \$825,081 in the third quarter of 2011 primarily due to decreases in natural gas and natural gas liquids prices and decreases in natural gas and natural gas liquids volume from the Hugoton Royalty Properties. The average price received in the third quarter of 2012 for natural gas and natural gas liquids sold from the Hugoton Royalty Properties was \$2.39 per Mcf and \$31.51 per barrel, respectively, as compared to \$4.52 per Mcf and \$55.36 per barrel, respectively, in the third quarter of 2011. Net production of natural gas attributable to the Hugoton Royalty decreased to 56,431 Mcf in the third quarter of 2012 from 102,310 Mcf in the third quarter of 2011. Net production of natural gas liquids attributable to the Hugoton Royalty decreased from 6,551 barrels in the third quarter of 2011 to 3,648 barrels in the third quarter of 2012. Actual production volumes from the Hugoton properties decreased to 124,330 Mcf of natural gas and 8,051 barrels of natural gas liquids in the third quarter of 2012 as compared to 141,690 Mcf of natural gas and 9,036 barrels of natural gas liquids for the same period in 2011. The decrease in production is a result of natural production decline.

The Hugoton capital expenditures were \$5,078 in the third quarter of 2012, an increase of approximately 105% as compared to \$2,475 in the third quarter of 2011. The increase in capital expenditures was primarily due to increased drilling activity. Operating costs were \$296,046 in the third quarter of 2012, a decrease of approximately 5% as compared to \$312,178 in the third quarter of 2011.

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### *San Juan Basin*

Natural gas and natural gas liquids production attributable to the Trust from the San Juan Basin New Mexico accounted for approximately 61% of the Royalty income of the Trust during the third quarter of 2012.

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 \$449,669 during the third quarter of 2012 as compared with Royalty income of \$1,076,090 during the third quarter of 2011. The decrease in Royalty income was due to lower natural gas and natural gas liquids prices, lower production volumes, and an increase in capital expenditures offset in part by a decrease in operating expenses for the third quarter of 2012 compared to the third quarter of 2011. Net production attributable to the San Juan Basin Royalty located in New Mexico was 97,755 Mcf of natural gas and 10,538 barrels of natural gas liquids in the third quarter of 2012, as compared to 133,482 Mcf of natural gas and 16,536 barrels of natural gas liquids in the third quarter of 2011. The average price received in the third quarter of 2012 for natural gas and natural gas liquids sold from the San Juan Basin Royalty Properties located in the State of New Mexico was \$1.83 per Mcf and \$25.70 per barrel, respectively, compared to \$3.37 per Mcf and \$36.44 per barrel, respectively, during the same period in 2011. Actual production volumes of natural gas attributable to the San Juan Basin properties located in the State of New Mexico decreased to 183,656 Mcf in the third quarter of 2012 as compared to 186,218 Mcf of natural gas for the same period in 2011. Actual production volumes of natural gas liquids attributable to the San Juan Basin properties located in the State of New Mexico decreased to 23,086 barrels in the third quarter of 2012 compared to 24,108 barrels for the same period in 2011.

Capital expenditures on these properties were \$118,432 in the third quarter of 2012, an increase of approximately 36% as compared to \$87,356 in the third quarter of 2011 primarily due to increased developmental drilling. Operating costs were \$274,753 in the third quarter 2012, a decrease of approximately 19% as compared to \$339,534 in the third quarter 2011 primarily due to a decrease in severance taxes.

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. Substantially all of the natural gas produced from the San Juan Basin is currently being sold on the spot market.

Natural gas and natural gas liquids production attributable to the Trust from the San Juan Basin Colorado accounted for approximately 5% of the Royalty income of the Trust during the third quarter of 2012.

Royalty income from the San Juan Basin Colorado Royalty Properties was \$37,752 during the third quarter of 2012, compared to \$179,855 during the third quarter of 2011. The decrease in Royalty income was due to lower gas prices, lower volume and increased operating costs in the third quarter of 2012 compared to the same period in 2011. Net production attributable to the San Juan Basin Royalty Properties located in Colorado was 30,119 Mcf of natural gas during the third quarter of 2012 with 62,285 Mcf of natural gas attributable to the Trust during the third quarter of 2011. The average price received in the third quarter of 2012 for natural gas sold from the San Juan Basin Colorado Properties was \$1.25, as compared to an average price of \$2.90 for the third quarter of 2011. Actual production volumes attributable to the San Juan Basin Colorado Properties increased to 55,544 Mcf of natural gas in the third quarter of 2012 as compared to 53,663 Mcf of natural gas for the same period in 2011. 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 by the Trust.



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Operating costs on these properties were \$32,804 in the third quarter of 2012, an increase of approximately 236% as compared to \$(24,095) in the third quarter of 2011.

### Nine Months Ended September 30, 2012 and 2011

#### Financial Review

	Nine Months Ended September 30,	
	2012	2011
Royalty income	\$ 2,926,291	\$ 5,023,799
Interest income	80,137	78
General and administrative expense	(235,424)	(118,231)
Distributable income	\$ 2,771,004	\$ 4,905,646
Distributable income per unit	\$ 1.4869	\$ 2.2299
Units outstanding	1,863,590	1,863,590

The Trust's Royalty income was \$2,926,291 for the nine months ended September 30, 2012, a decrease of approximately 42% as compared to \$5,023,799 for the nine months ended September 30, 2011, primarily as a result of lower natural gas prices and lower natural gas and NGL production volumes in the first nine months of 2012 as compared to the first nine months of 2011. The Trust's Interest income for the nine months ended September 30, 2012 was \$80,137, an increase from \$78 for the nine months ended September 30, 2011. In accordance with the Trust Indenture, interest on cash on hand was paid at a rate of 1.5% below the prime interest rate. In addition, General and administrative expense increased to \$235,424 for the first nine months of 2012, compared to \$118,231 for the first nine months of 2011. The increase was a result of Trust administrative expenses incurred in the first nine months of 2012 that are expected to be reimbursed in accordance with the Trust Indenture in the fourth quarter of 2012.

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 nine months ended September 30, 2012 was \$2,771,004, representing \$1.4869 per unit, compared to \$4,905,646, representing \$2.2299 per unit, for the nine months ended September 30, 2011 after the withholding of cash for future unknown contingent liabilities and expenses.

Effective January 1, 2011, the Trustee began withholding \$83,333 of cash per month for future unknown contingent liabilities and expenses in accordance with the Trust Indenture. The cash withholding was established through the withholding of cash received during 2011 of approximately \$83,333 per monthly distribution amount, or up to \$250,000 per quarter, until the cash withholding reached \$1.0 million. At September 30, 2011 and December 31, 2011, the Trust had withheld a total of \$750,000 and \$1.0 million, respectively, which is included in cash and short term investments. The effect on distributable income per unit is as follows:

	Nine Months Ended September 30,	
	2012	2011
Distributable Income Before Reserve for Contingent Liabilities and Expenses	\$ 2,082,195	4,905,646
Reserve for Contingent Liabilities and Expenses (See Note 1)		(750,000)
Distributable Income Available for Distribution	2,082,195	4,155,646
Distributable Income Per Unit	\$ 1.1173	\$ 2.2299
Units Outstanding	1,863,590	1,863,590

*Operational Review*

*Hugoton Field*

Natural gas and natural gas liquids revenue from the Hugoton field attributable to the Trust accounted for approximately 39% of the Royalty income of the Trust during the nine months ended September 30, 2012.

Royalty income attributable to the Hugoton Royalty Properties decreased to \$1,145,191 for the nine months ended September 30, 2012 from \$1,970,079 for the same period in 2011 primarily due to lower prices for natural gas and natural gas liquids, decreased production, and decreased capital expenditures offset by increased operating expenditures from the Hugoton Royalty Properties. The average price received in the first nine months of 2012 for natural gas and natural gas liquids sold from the Hugoton field was \$3.03 per Mcf and \$41.40 per barrel, respectively, compared to \$4.24 per Mcf and \$51.07 per barrel, respectively, during the same period in 2011. Net production attributable to the Hugoton Royalty Properties decreased to 214,302 Mcf of natural gas and 11,977 barrels of natural gas liquids for the nine months ended September 30, 2012 as compared to 277,205 Mcf of natural gas and 15,562 barrels of natural gas liquids for the nine months ended September 30, 2011. Actual production volumes attributable to the Hugoton Royalty Properties decreased to 397,149 Mcf of natural gas and decreased to 22,367 barrels of natural gas liquids in the nine months ended September 30, 2012 as compared to 425,016 Mcf of natural gas and 23,286 barrels of natural gas liquids for the same period in 2011. The decrease in production is a result of natural production decline.

The Hugoton capital expenditures were \$6,219 during the nine months ended September 30, 2012, a decrease of approximately 94% as compared to \$102,212 during the nine months ended September 30, 2011. The decrease in the capital expenditures was primarily due to decreased drilling activity. Operating costs were \$976,900 during the nine months ended September 30, 2012, an increase of approximately 6% as compared to \$918,973 during the nine months ended September 30, 2011.

*San Juan Basin*

Natural gas and natural gas liquids revenue from the San Juan Basin New Mexico attributable to the Trust accounted for approximately 53% of the Royalty income of the Trust during the nine months ended September 30, 2012.

The Royalty income from the San Juan Basin Royalty Properties located in the state of New Mexico was \$1,558,031 for the first nine months of 2012 compared to \$2,713,541 in the first nine months of 2011. The decrease in Royalty income was due primarily to lower natural gas prices, lower production volumes and increased capital expenditures offset in part by lower operating costs from the San Juan Basin properties during the nine months ended September 30, 2012. The average price received in the nine months ended September 30, 2012 for natural gas and natural gas liquids sold from the San Juan Basin Royalty Properties located in the state of New Mexico was \$1.98 per Mcf and \$30.46 per barrel, respectively, compared to \$3.08 per Mcf and \$34.07 per barrel, respectively, during the same period in 2011. Net production attributable to the San Juan Basin Royalty located in New Mexico was 267,042 Mcf of natural gas and 33,783 barrels of natural gas liquids for the nine months ended September 30, 2012 as compared to 392,121 Mcf of natural gas and 43,094 barrels of natural gas liquids for the nine months ended September 30, 2011. Actual production volumes attributable to the San Juan Basin Royalty Properties decreased to 521,679 Mcf of natural gas and increased to 70,058 barrels of natural gas liquids in the nine months ended September 30, 2012 as compared to 572,751 Mcf of natural gas and 67,096 barrels of natural gas liquids for the same period in 2011.

San Juan-New Mexico capital expenditures were \$612,141 during the nine months ended September 30, 2012, an increase of approximately 116% as compared to \$282,993 during the nine months ended September 30, 2011. This increase is due to increased developmental drilling activity

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during the nine months ended September 30, 2012 when compared to the nine months ended September 30, 2011. Operating costs were \$938,249 during the nine months ended September 30, 2012, a decrease of approximately 6% as compared to \$993,415 during the nine months ended September 30, 2011.

Natural gas and natural gas liquids revenue from the San Juan Basin Colorado attributable to the Trust accounted for approximately 8% of the Royalty income of the Trust during the nine months ended September 30, 2012.

Royalty income from the San Juan Basin Colorado Royalty Properties was \$223,069 for the nine months ended September 30, 2012, compared to \$340,166 during the same period in 2011. The decrease in Royalty income was primarily the result of lower natural gas prices in the nine months ended September 30, 2012 compared to the same period in 2011. Net production attributable to the San Juan Basin Royalty Properties located in Colorado was 126,631 Mcf of natural gas during the nine months ended September 30, 2012 with 122,998 Mcf of natural gas attributable to the Trust during the same period in 2011. The average price received for the nine months ended September 30, 2012 for natural gas sold from the San Juan Basin Colorado Properties was \$1.76, compared to \$2.77 received during the same period in 2011. Actual production volumes attributable to the San Juan Basin Colorado Properties increased to 162,664 Mcf of natural gas for the nine months ended September 30, 2012 as compared to 145,450 Mcf of natural gas for the same period in 2011.

Operating costs on these properties were \$62,469 for the nine months ended September 30, 2012, as compared to \$62,853 in the same period in 2011.

### **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, regulation of green house gas and other emissions associated with fossil fuel combustion 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



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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 Mellon 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.

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, 2011 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.

The officer acting on behalf of the Trustee has not conducted a separate evaluation of the disclosure controls and procedures with respect to information furnished by the working interest owners. The Trustee notes that with respect to the annual reports on Form 10-K for December 31, 2007 and 2008, and with respect to the quarterly reports during 2008 and for the first two quarters of 2009, the Trust did not file its reports in a timely manner due to the Trustee's need to reconcile and verify ownership, calculations of the Trust's interest in proceeds and other information provided by working interest owners. This information was required by the reserve engineer to prepare the reserve report for the Trustee to present the required reserve information in the SEC reports, and for the Trustee to complete the Trust's financial statements, and a review of the basis for this information was needed prior to filing these reports. The source of this information is not within the control of the Trustee, and thus the initial information provided to the Trustee and the timely receipt of accurate information for the preparation of these reports was not within scope of the Trustee's disclosure controls and procedures. The Trustee's review of certain information and calculations by the working interest owners, along with an outside joint venture auditor, remains ongoing. See "Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources" under Item 7 on Form 10-K for the year ended December 31, 2011 for information concerning controls and procedures with respect to the Royalty.

*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. The Trustee has been advised by PNR, ConocoPhillips and BP Amoco that it is subject to litigation in the ordinary course of business for certain matters that include the Royalty Properties. While each of the working interest owners has advised the Trustee that it does not currently believe any of the pending litigation will have a material adverse effect net to the Trust, in the event such matters were adjudicated or settled in a material amount and charges were made against Royalty income, such charges could have a material impact 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, 2011.

**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 was successor by mergers to the original name of the Trustee, Texas Commerce Bank National Association).

	SEC File or Registration Number	Exhibit Number
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)	1-7884	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)	1-7884	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)	1-7884	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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