

MESA ROYALTY TRUST/TX
Form 10-Q
August 09, 2006

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 JUNE 30, 2006**
 **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE TRANSITION PERIOD FROM TO**

Commission File Number: 1-07884

MESA ROYALTY TRUST

(Exact Name of Registrant as Specified in its Charter)

Texas
(State or other Jurisdiction of
Incorporation or Organization)
JPMorgan Chase Bank, N.A., Trustee
Institutional Trust Services
221 West Sixth Street
Austin, Texas

(Address of Principal Executive Offices)

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

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

78701
(Zip Code)

(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, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date. As of August 9, 2006 1,863,590 Units of Beneficial Interest in Mesa Royalty Trust.

PART I FINANCIAL INFORMATION

Item 1. *Financial Statements.*
MESA ROYALTY TRUST
STATEMENTS OF DISTRIBUTABLE INCOME
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Royalty income	\$ 2,472,887	\$ 2,244,561	\$ 6,053,237	\$ 4,783,802
Interest income	6,480	3,545	14,342	7,160
General and administrative expense	(16,468)	(19,608)	(38,433)	(39,612)
Distributable income	\$ 2,462,899	\$ 2,228,498	\$ 6,029,146	\$ 4,751,350
Distributable income per unit	\$ 1.3216	\$ 1.1958	\$ 3.2352	\$ 2.5496
Units outstanding	1,863,590	1,863,590	1,863,590	1,863,590

STATEMENTS OF ASSETS, LIABILITIES AND TRUST CORPUS

	June 30, 2006 (Unaudited)	December 31, 2005
ASSETS		
Cash and short-term investments	\$ 2,456,419	\$ 3,378,013
Interest receivable	6,480	6,280
Net overriding royalty interest in oil and gas properties	42,498,034	42,498,034
Accumulated amortization	(34,185,597)	(33,976,766)
Total assets	\$ 10,775,336	\$ 11,905,561
LIABILITIES AND TRUST CORPUS		
Distributions payable	\$ 2,462,899	\$ 3,384,268
Trust corpus (1,863,590 units of beneficial interest authorized and outstanding)	8,312,437	8,521,268
Total liabilities and trust corpus	\$ 10,775,336	\$ 11,905,536

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

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

	Three Months Ended		Six Months Ended	
	June 30, 2006	2005	June 30, 2006	2005
Trust corpus, beginning of period	\$ 8,415,540	\$ 8,892,121	\$ 8,521,268	\$ 9,017,067
Distributable income	2,462,899	2,228,498	6,029,146	4,751,350
Distributions to unitholders	(2,462,899)	(2,228,498)	(6,029,146)	(4,751,350)
Amortization of net overriding royalty interest	(103,103)	(122,881)	(208,831)	(247,827)
Trust corpus, end of period	\$ 8,312,437	\$ 8,769,240	\$ 8,312,437	\$ 8,769,240

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

MESA ROYALTY TRUST
NOTES TO FINANCIAL STATEMENTS
(Unaudited)

Note 1 Trust Organization

The Mesa Royalty Trust (the Trust) was created on November 1, 1979 when Mesa Petroleum Co. conveyed to the Trust a 90% net profits overriding royalty interest (the Royalty) in certain producing oil and gas properties located in the Hugoton field of Kansas, the San Juan Basin field of New Mexico and Colorado and the Yellow Creek field of Wyoming (collectively, the Royalty Properties). Mesa Petroleum Co. was the predecessor to Mesa Limited Partnership (MLP), the predecessor to MESA Inc. On April 30, 1991, MLP sold its interests in the Royalty Properties located in the San Juan Basin field to ConocoPhillips (successor by merger to Conoco, Inc.). ConocoPhillips sold most of its interests in the San Juan Basin Royalty Properties located in Colorado to MarkWest Energy Partners, Ltd. (effective January 1, 1993) and Red Willow Production Company (effective April 1, 1992). On October 26, 1994, MarkWest Energy Partners, Ltd. sold substantially all of its interest in the Colorado San Juan Basin Royalty Properties to BP Amoco Company (BP), a subsidiary of BP p.l.c. Until August 7, 1997, MESA Inc. operated the Hugoton Royalty Properties through Mesa Operating Co., a wholly owned subsidiary of MESA Inc. On August 7, 1997, MESA Inc. merged with and into Pioneer Natural Resources Company (Pioneer), formerly a wholly owned subsidiary of MESA Inc., and Parker & Parsley Petroleum Company merged with and into Pioneer Natural Resources USA, Inc. (successor to Mesa Operating Co.), a wholly owned subsidiary of Pioneer (PNR) (collectively, the mergers are referred to herein as the Merger). Subsequent to the Merger, the Hugoton Royalty Properties have been operated by PNR. All of the San Juan Basin Royalty Properties located in New Mexico and a few wells located in Southwest Colorado near the New Mexico border, are operated by ConocoPhillips. Substantially all of the San Juan Basin Royalty Properties located in Colorado are operated by BP. As used in this report, PNR refers to the operator of the Hugoton Royalty Properties, ConocoPhillips refers to the operator of the San Juan Basin Royalty Properties, other than the portion of such properties located in Colorado, and BP refers to the operator of the Colorado San Juan Basin Royalty Properties unless otherwise indicated. The terms working interest owner and working interest owners generally refer to the operators of the Royalty Properties as described above, unless the context in which such terms are used indicates otherwise.

Unless sooner terminated, the Trust Agreement provides that the Trust will terminate in the event that the net revenues fall below \$250,000 for two successive years. Net revenues are calculated as royalty and interest income after administrative expenses of the Trust. The Trust may be terminated at any time by a vote of unitholders owning a majority of the Units. The Trust may also be terminated at the expiration of twenty-one years after the death of the last to die of all of the descendants living at the date of execution of this Trust Agreement of Joseph P. Kennedy, late father of the late President of the United States, John F. Kennedy.

Upon termination of the Trust, the Trustee shall sell for cash all the assets. The Trustee shall as promptly as possible distribute the proceeds of any such sales and any other cash according to the respective interests and rights of the unitholders, after paying, satisfying and discharging all the liabilities of the Trust, or, when necessary, setting up reserves in such amounts as Trustee in its discretion deems appropriate for contingent liabilities.

In the event that any property which the Trustee is required to sell is not sold by the Trustee within three years after the termination of the Trust, the Trustee shall cause such property to be sold at public auction to the highest cash bidder. Notice of such sale by auction shall be mailed at least thirty days prior to such sale to each unitholder at his address as it appears upon the books of the Trustee.

Note 2 Basis of Presentation

The accompanying unaudited financial information has been prepared by JPMorgan Chase Bank, N.A. (Trustee), in accordance with the instructions to Form 10-Q. JPMorgan Chase Bank, N.A. was formerly known as The Chase Manhattan Bank and is the successor by mergers to the original name of the Trustee, Texas Commerce Bank National Association. The preparation of the financial statements requires estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting periods. Actual results could differ from those estimates. The Trustee believes such information includes all the disclosures necessary to make the information presented not misleading. The information furnished reflects all adjustments which are, in the opinion of the Trustee, necessary for a fair presentation of the results for the interim periods presented. The financial information should be read in conjunction with the financial statements and notes thereto included in the Trust's 2005 Annual Report on Form 10-K.

On April 8, 2006, JP Morgan Chase Bank, N.A. and Bank of New York announced an agreement pursuant to which Bank of New York would acquire JPMorgan Chase's corporate trust business. The transaction has been approved by both companies' boards of directors. Subject to regulatory approvals, the transaction is expected to close in the late third quarter or fourth quarter of 2006. The transaction is not expected to have any material effect on the Trust.

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

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

- (a) Royalty income recorded for a month is the amount computed and paid by the working interest owners to the Trustee for such month rather than either the value of a portion of the oil and gas produced by the working interest owners for such month or the amount subsequently determined to be the Trust's proportionate share of the net proceeds for such month;
- (b) Interest income, interest receivable and distributions payable to unitholders include interest to be earned on short-term investments from the financial statement date through the next date of distribution;
- (c) Trust general and administrative expenses, net of reimbursements, are recorded in the month they accrue;
- (d) Amortization of the net overriding royalty interests, which is calculated on a unit-of-production basis, is charged directly to trust corpus since such amount does not affect distributable income; and
- (e) Distributions payable are determined on a monthly basis and are payable to unitholders of record as of the last business day of each month or such other day as the Trustee determines is required to comply with legal or stock exchange requirements. However, cash distributions are made quarterly in January, April, July and October, and include interest earned from the monthly record dates to the date of distribution.

This basis for reporting distributable income is thought to be the most meaningful because distributions to the unitholders for a month are based on net cash receipts for such month. However, it will differ from the basis used for financial statements prepared in accordance with accounting principles

accepted in the United States of America because under these accounting principles, royalty income for a month would be based on net proceeds from production for such month without regard to when calculated or received and interest income for a month would be calculated only through the end of such month.

Note 3 Legal Proceedings

PNR has informed the trust that PNR is party to a 1993 class action lawsuit filed in the 26th Judicial District Court of Stevens County, Kansas by two classes of royalty owners, one for each of PNR's gathering systems connected to PNR's Satanta gas plant. The case was relatively inactive for several years. In early 2000, the plaintiffs amended their pleadings and the case now contains two material claims. First, the plaintiffs assert that they were improperly charged expenses (primarily field compression), which plaintiffs allege are a cost of production, and for which the plaintiffs claim they, as royalty owners, are not responsible. Second, the plaintiffs claim they are entitled to 50 percent of the value of the helium extracted at PNR's Satanta gas plant. If the plaintiffs were to prevail on the above two claims in their entirety, it is possible that PNR's liability (both for periods covered by the lawsuit and from the last date covered by the lawsuit to the present - because the deductions continue to be taken and the plaintiffs continue to be paid for a royalty share of the helium) could reach approximately \$74 million, plus prejudgment interest. PNR has advised that the Trust's share of this amount could reach \$4.8 million, plus prejudgment interest. In addition to the plaintiffs' past damage claims, if the plaintiffs were to prevail, it is possible that in future periods of time, PNR would have to stop charging certain expenses and as a result, the Trust's production costs and royalty payments related to the area would increase. However, PNR believes it has valid defenses to the plaintiffs' claims and has paid the plaintiffs properly under their respective oil and gas leases and other agreements, and intends to vigorously defend itself.

PNR does not believe the costs it has deducted are a cost of production. The costs being deducted are post production costs incurred to transport the gas to PNR's Satanta gas plant for processing, where the valuable hydrocarbon liquids and helium are extracted from the gas.

The factual evidence in the case was presented to the 26th Judicial District Court without a jury in December 2001. Oral arguments were heard by the court in April 2002, and although the court has not yet entered a judgment or findings, it could do so at any time. PNR strongly denies the existence of any material underpayment to the plaintiffs and believes it presented strong evidence at trial to support its positions. However, either through a negotiated settlement or court ruling, PNR could have to pay some part of the cost of production claim and, accordingly, PNR has established a partial reserve for this claim. PNR has not established a provision for the helium claim. PNR has not withheld any amounts from Royalty income payable to the Trust. Accordingly, the amount of any resulting liability or settlement payment could have a material adverse effect on the Trust's Royalty income and distributable income for the quarterly reporting period in which such liability or settlement payment is recorded and subsequent reporting periods until the Trust's share of such amounts are recouped by PNR from future Royalty income.

Entry of a final judgment or settlement payment adverse to PNR would reduce any amount available for distribution to the Trust for the period in which the liability or settlement payment is recorded and during periods required for PNR to recoup any additional amounts.

The Trustee has been advised by ConocoPhillips that it is subject to litigation in the ordinary course of business for certain matters that include the Royalty Properties. While the working interest owner 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.

Note 4 Federal Income Tax Matters

In a technical advice memorandum dated February 26, 1982, the National Office of 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. Accordingly, no income taxes are provided in the financial statements.

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

The following review of the Trust's financial condition and results of operations should be read in conjunction with the financial statements and notes thereto. The discussion of net production attributable to the Hugoton and San Juan properties represents production volumes that are to a large extent hypothetical as the Trust does not own and is not entitled to any specific production volumes. See Note 7 to the financial statements in the Trust's 2005 Annual Report on Form 10-K. Any discussion of actual production volumes represents the hydrocarbons that were produced from the properties in which the Trust has an overriding royalty interest.

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

Note Regarding Forward-Looking Statements

This Form 10-Q includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements other than statements of historical facts included in this Form 10-Q, including without limitation the statements under Management's Discussion and Analysis of Financial Condition and Results of Operations are forward-looking statements. Although the Working Interest Owners have advised the Trust that they believe that the expectations reflected in the forward-looking statements contained herein are reasonable, no assurance can be given that such expectations will prove to have been 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 2005 Annual Report on Form 10-K, including under Item 1A Risk Factors . All subsequent written and oral forward-looking statements attributable to the Trust or persons acting on its behalf are expressly qualified in their entirety by the Cautionary Statements.

SUMMARY OF ROYALTY INCOME AND AVERAGE PRICES
(Unaudited)

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

	Three Months Ended June 30, 2006		2005	
	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)	\$ 2,947,759	\$ 869,129	\$ 2,735,473	\$ 741,521
Less the Trust's proportionate share of:				
Capital costs recovered(2)	(225,735)		(246,397)	
Operating costs	(878,555)	(70,737)	(777,741)	(87,838)
Withheld revenues(3)	(168,974)		(120,457)	
Royalty income	\$ 1,674,495	\$ 798,392	\$ 1,590,878	\$ 653,683
Average sales price	\$ 6.79	\$ 38.83	\$ 5.77	\$ 30.75
	(Mcf)	(Bbls)	(Mcf)	(Bbls)
Net production volumes attributable to the Royalty paid(4)	246,524	20,561	275,769	21,261
	Six Months Ended June 30, 2006		2005	
	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)	\$ 7,400,870	\$ 1,775,320	\$ 5,650,245	\$ 1,580,614
Less the Trust's proportionate share of:				
Capital costs recovered(2)	(532,634)		(450,030)	
Operating costs	(1,981,420)	(147,565)	(1,535,529)	(168,593)
Withheld revenues(3)	(461,334)		(292,905)	
Royalty income	\$ 4,425,482	\$ 1,627,755	\$ 3,371,781	\$ 1,412,021
Average sales price	\$ 8.33	\$ 40.49	\$ 5.89	\$ 32.25
	(Mcf)	(Bbls)	(Mcf)	(Bbls)
Net production volumes attributable to the Royalty paid(4)	531,391	40,202	572,512	43,785

(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) Capital costs recovered represents capital costs incurred during the current or prior periods to the extent that such costs have been recovered by the working interest owners from current period Gross Proceeds.

(3) The Colorado portion of the San Juan Basin Royalty properties have recouped all costs related to the Fruitland Coal drilling program as of December 2004. However, subsequent cumulative earnings totaling \$1,083,642 have not yet been remitted to the Trust. Since Royalty income for the Trust is recorded on a cash basis, Royalty income for the quarters ended June 30, 2006 and 2005 of \$168,974 and \$120,457, respectively, and Royalty income for the six months ended June 30, 2006 and 2005 of \$461,334 and \$292,905, respectively cannot be recognized.

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

Three Months Ended June 30, 2006 and 2005

	Three Months Ended June 30,	
	2006	2005
Royalty income	\$ 2,472,887	\$ 2,244,561
Interest income	6,480	3,545
General and administrative expense	(16,468)	(19,608)
Distributable income	\$ 2,462,899	\$ 2,228,498
Distributable income per unit	\$ 1.3216	\$ 1.1958
Units outstanding	1,863,590	1,863,590

The Trust's Royalty income was \$2,472,887 in the second quarter 2006, an increase of approximately 10% as compared to \$2,244,561 in the second quarter of 2005, primarily as a result of higher natural gas and natural gas liquid prices in the second quarter of 2006 as compared to the second quarter of 2005, offset slightly by decreased production.

The distributable income of the Trust for each period includes the Royalty income received from the working interest owners during such period, plus interest income earned to the date of distribution. Trust administration expenses are deducted in the computation of distributable income. Distributable income for the quarter ended June 30, 2006 was \$2,462,899, representing \$1.3216 per unit, compared to \$2,228,498, representing \$1.1958 per unit, for the quarter ended June 30, 2005. Based on 1,863,590 units outstanding for the quarters ended June 30, 2006 and 2005, respectively, the per unit distributions were as follows:

	2006	2005
April	\$ 0.5302	\$ 0.3886
May	0.4168	0.4181
June	0.3746	0.3891
	\$ 1.3216	\$ 1.1958

Hugoton Field

Natural gas and natural gas liquids production attributable to the Royalty from the Hugoton field accounted for approximately 57% of the Royalty income of the Trust during the second quarter of 2006.

PNR has advised the Trust that since June 1, 1995 natural gas produced from the Hugoton field has generally been sold under short-term and multi-month contracts at market clearing prices to multiple purchasers recently including Greely Gas and Oneok 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 higher in the second quarter of 2006 compared to the second quarter of 2005.

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 been continued in effect on a year-to-year basis since June 1, 2001. PNR extended the contract to June 1, 2007. Pursuant to the Gas Transportation Agreement, WRI has 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 has been assigned to Kansas Gas Service (Oneok).

Royalty income attributable to the Hugoton Royalty increased to \$1,446,705 in the second quarter of 2006, as compared to \$1,150,474 in the second quarter of 2005. The increase in Royalty income was primarily due to higher natural gas, condensate and natural gas liquid prices. The average price received in the second quarter of 2006 for natural gas and natural gas liquids sold from the Hugoton Royalty Properties was \$7.41 per Mcf and \$39.60 per barrel, respectively, compared to \$6.02 per Mcf and \$29.72 per barrel, respectively, during the same period in 2005. Net production attributable to the Hugoton Royalty was 136,201 Mcf of natural gas and 11,048 barrels of natural gas liquids in the second quarter of 2006 compared to 134,439 Mcf of natural gas and 11,479 barrels of natural gas liquids in the second quarter of 2005. Actual production volumes attributable to the Hugoton properties decreased to 182,538 Mcf of natural gas and 11,054 barrels of natural gas liquids in the second quarter of 2006 as compared to 191,237 Mcf of natural gas and 11,478 barrels of natural gas liquids for the same period in 2005 as a result of natural production decline.

Capital expenditures on these properties were \$57,484 in the second quarter of 2006, a decrease of approximately 21% as compared to \$73,150 in the second quarter of 2005. Operating costs were \$285,021 in the second quarter of 2006, an increase of approximately 6% as compared to \$267,902 in the second quarter of 2005.

Allowable rates of production in the Hugoton field are set by the Kansas Corporation Commission (the KCC) based on the level of market demand. The KCC has set the Hugoton field allowable for the period April 1, 2006 through September 30, 2006, at 124.7 Bcf of gas, compared with 129.5 Bcf of gas during the same period last year.

San Juan Basin

Royalty income from the San Juan Basin Royalty Properties is calculated and paid to the Trust on a state-by-state basis. Substantially all of the Royalty income from the San Juan Basin Royalty Properties are

Edgar Filing: MESA ROYALTY TRUST/TX - Form 10-Q

located in the state of New Mexico. The Royalty income was \$1,026,182 during the second quarter of 2006 as compared with \$1,094,087 in the second quarter of 2005. The average price received in the second quarter of 2006 for natural gas sold from the San Juan Basin Royalty Properties was \$6.03 per Mcf and \$37.94 per barrel, respectively, compared to \$5.53 per Mcf and \$31.95 per barrel during the same period in 2005. Net production attributable to the San Juan Basin Royalty located in New Mexico was 110,323 Mcf of natural gas and 9,513 barrels of natural gas liquids in the second quarter of 2006 as compared to 141,330 Mcf of natural gas and 9,782 barrels of natural gas liquids in the second quarter of 2005. Actual production volumes attributable to the San Juan Basin properties decreased to 226,748 Mcf of natural gas and 11,379 barrels of natural gas liquids in the second quarter of 2006 as compared to 259,320 Mcf of natural gas and 12,533 barrels of natural gas liquids for the same period in 2005 as a result of natural production decline.

Capital expenditures on these properties were \$168,251 in the second quarter of 2006, a decrease of approximately 3% as compared to \$173,247 in the second quarter of 2005. Operating costs were \$604,522 in the second quarter of 2006, an increase of approximately 7% as compared to \$566,069 in the second quarter of 2005.

The Trust's interest in the San Juan Basin was conveyed from PNR's working interest in 31,328 net producing acres in northwestern New Mexico and southwestern Colorado. The San Juan Basin New Mexico reserves represented approximately 72% of the Trust's estimated reserves as of December 31, 2005. Substantially all of the natural gas produced from the San Juan Basin is currently being sold on the spot market. The San Juan Basin Royalty Properties located in Colorado account for less than 5% of the Trust's reserves as of December 31, 2005.

The costs related to the San Juan Basin, Colorado portion were recovered in December 2004. However, subsequent earnings now totaling \$1,083,642 based on reports provided by BP have not been remitted by BP. Since Royalty income for the Trust is recorded on a cash basis, the second quarter 2006 earnings of \$168,974 cannot be recognized as income for the quarter ended June 30, 2006. The Trustee is currently pursuing payment or a response from BP as to why payments have not been made in a timely manner but cannot predict at this time when payment will be made.

Six Months Ended June 30, 2006 and 2005

	Six Months Ended	
	June 30,	
	2006	2005
Royalty income	\$ 6,053,237	\$ 4,783,802
Interest income	14,342	7,160
General and administrative expense	(38,433)	(39,612)
Distributable income	\$ 6,029,146	\$ 4,751,350
Distributable income per unit	\$ 3.2352	\$ 2.5496
Units outstanding	1,863,590	1,863,590

The Trust's Royalty income was \$6,053,237 for the six months ended June 30, 2006, an increase of approximately 27% as compared to \$4,783,802 for the six months ended June 30, 2005, primarily as a result of higher natural gas and natural gas liquid prices in the first six months of 2006 as compared to the first six months of 2005, offset slightly by decreased production.

Edgar Filing: MESA ROYALTY TRUST/TX - Form 10-Q

The distributable income of the Trust for each period includes the Royalty income received from the working interest owners during such period, plus interest income earned to the date of distribution. Trust administration expenses are deducted in the computation of distributable income. Distributable income for the six months ended June 30, 2006 was \$6,029,146, representing \$3.2352 per unit, compared to \$4,751,350, representing \$2.5496 per unit, for the six months ended June 30, 2005.

Hugoton Field

Natural gas and natural gas liquids from the Hugoton field and attributable to the Royalty accounted for approximately 57% of the Royalty income of the Trust during the six months ended June 30, 2006.

Royalty income attributable to the Hugoton Royalty Properties increased to \$3,471,763 for the six months ended June 30, 2006 from \$2,543,648 for the same period in 2005 primarily due to increases in natural gas and natural gas liquids price from the Hugoton Royalty Properties. The average price received in the first six months of 2006 for natural gas and natural gas liquids sold from the Hugoton field was \$9.11 per Mcf and \$41.81 per barrel, respectively, compared to \$6.08 per Mcf and \$32.42 per barrel, respectively, during the same period in 2005. Net production attributable to the Hugoton Royalty Properties decreased to 285,541 Mcf of natural gas and 20,820 barrels of natural gas liquids for the six months ended June 30, 2006 as compared to 292,794 Mcf of natural gas and 23,549 barrels of natural gas liquids for the six months ended June 30, 2005. Actual production volumes attributable to the Hugoton Royalty Properties decreased to 372,328 Mcf of natural gas and 20,831 barrels of natural gas liquids in the six months ended June 30, 2006 as compared to 395,889 Mcf of natural gas and 23,549 barrels of natural gas liquids for the same period in 2005 as a result of natural production decline.

The Hugoton capital expenditures were \$153,768 during the six months ended June 30, 2006, an increase of approximately 97% as compared to \$77,999 during the six months ended June 30, 2005. Operating costs were \$633,654 during the six months ended June 30, 2006, an increase of approximately 15% as compared to \$549,342 during the six months ended June 30, 2005.

San Juan Basin

Royalty income from the San Juan Basin Royalty Properties is calculated and paid to the Trust on a state-by-state basis. Substantially all of the Royalty income from the San Juan Basin Royalty Properties are located in the state of New Mexico. The Royalty income was \$2,581,474 for the first six months of 2006 compared to \$2,240,154 in the first six months of 2005. The increase in Royalty income was due primarily to increased natural gas and natural gas liquid prices in the first six months of 2006 from the San Juan Basin properties. The average price received in the six months ended June 30, 2006 for natural gas and natural gas liquids sold from the San Juan Basin Royalty Properties was \$7.42 per Mcf and \$39.07 per barrel, respectively, compared to \$5.70 per Mcf and \$32.06 per barrel, respectively, during the same period in 2005. Net production attributable to the San Juan Basin Royalty located in New Mexico was 245,850 Mcf of natural gas and 19,382 barrels of natural gas liquids for the six months ended June 30, 2006 as compared to 279,718 Mcf of natural gas and 20,236 barrels of natural gas liquids for the six months ended June 30, 2005. Actual production volumes attributable to the San Juan Basin Royalty Properties decreased to 464,072 Mcf of natural gas and 23,161 barrels of natural gas liquids in the six months ended June 30, 2006 as compared to 509,293 Mcf of natural gas and 25,494 barrels of natural gas liquids for the same period in 2005 as a result of natural production decline.

San Juan-New Mexico capital expenditures were \$378,865 during the six months ended June 30, 2006, an increase of approximately 2% as compared to 372,031 during the six months ended June 30, 2005. Operating costs were \$1,386,021 during the six months ended June 30, 2006, an increase of approximately 26% as compared to \$1,101,648 during the six months ended June 30, 2005.

The costs related to the San Juan Basin, Colorado portion were recovered in December 2004. However, subsequent earnings now totaling \$1,083,642 based on reports provided by BP have not been remitted by BP. Since Royalty income is recorded on a cash basis, earnings of \$461,334 cannot be recognized as income for the six months ended June 30, 2006. The Trustee is currently pursuing payment or a response from BP as to why payments have not been made in a timely manner but cannot predict at this time when payment will be made.

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

The Trust does not utilize market risk sensitive instruments. However, see the discussion of marketing by the working interest owners above.

Item 4. *Controls and Procedures.*

Evaluation of Disclosure Controls and Procedures. The Trustee maintains disclosure controls and procedures designed to ensure that information required to be disclosed by the Trust in the reports that it files or submits under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and regulations. Disclosure controls and procedures include controls and procedures designed to ensure that information required to be disclosed by the Trust is accumulated and communicated by the working interest owners to JPMorgan Chase Bank, 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 Trustee carried out an evaluation of the Trustee's disclosure controls and procedures. Mike Ulrich, as Trust Officer of the Trustee, has concluded that these controls and procedures are effective.

Due to the contractual arrangements of (i) the Trust Indenture and (ii) the rights of the Partnership 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, 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** None of the Trustee, the Trust nor its unitholders control the operation or development of the Royalty Properties and have little influence over operation or development and -The Trustee relies upon the working interests owners for information regarding the Royalty Properties in the Trust's 2005 Annual Report on Form 10-K for a description of certain risks relating to these arrangements and reliance.

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.

PART II OTHER INFORMATION

Item 1. *Legal Proceedings.*

PNR has informed the trust that PNR is party to a 1993 class action lawsuit filed in the 26th Judicial District Court of Stevens County, Kansas by two classes of royalty owners, one for each of PNR's gathering systems connected to PNR's Satanta gas plant. The case was relatively inactive for several years. In early 2000, the plaintiffs amended their pleadings and the case now contains two material claims. First, the plaintiffs assert that they were improperly charged expenses (primarily field compression), which plaintiffs allege are a cost of production, and for which the plaintiffs claim they, as royalty owners, are not responsible. Second, the plaintiffs claim they are entitled to 50 percent of the value of the helium extracted at PNR's Satanta gas plant. If the plaintiffs were to prevail on the above two claims in their entirety, it is possible that PNR's liability (both for periods covered by the lawsuit and from the last date covered by the lawsuit to the present - because the deductions continue to be taken and the plaintiffs continue to be paid for a royalty share of the helium) could reach approximately \$74 million, plus prejudgment interest. PNR has advised that the Trust's share of this amount could reach \$4.8 million, plus prejudgment interest. In addition to the plaintiffs' past damage claims, if the plaintiffs were to prevail, it is possible that in future periods of time, PNR would have to stop charging certain expenses and as a result, the Trust's production

costs and royalty payments related to the area would increase. However, PNR believes it has valid defenses to the plaintiffs' claims and has paid the plaintiffs properly under their respective oil and gas leases and other agreements, and intends to vigorously defend itself.

PNR does not believe the costs it has deducted are a cost of production. The costs being deducted are post production costs incurred to transport the gas to PNR's Satanta gas plant for processing, where the valuable hydrocarbon liquids and helium are extracted from the gas.

The factual evidence in the case was presented to the 26th Judicial District Court without a jury in December 2001. Oral arguments were heard by the court in April 2002, and although the court has not yet entered a judgment or findings, it could do so at any time. PNR strongly denies the existence of any material underpayment to the plaintiffs and believes it presented strong evidence at trial to support its positions. However, either through a negotiated settlement or court ruling, PNR could have to pay some part of the cost of production claim and, accordingly, PNR has established a partial reserve for this claim. PNR has not established a provision for the helium claim. PNR has not withheld any amounts from Royalty income payable to the Trust. Accordingly, the amount of any resulting liability or settlement payment could have a material adverse effect on the Trust's Royalty income and distributable income for the quarterly reporting period in which such liability or settlement payment is recorded and subsequent reporting periods until the Trust's share of such amounts are recouped by PNR from future Royalty income.

Entry of a final judgment or settlement payment adverse to PNR would reduce any amount available for distribution to the Trust for the period in which the liability or settlement payment is recorded and during periods required for PNR to recoup any additional amounts.

The Trustee has been advised by ConocoPhillips that it is subject to litigation in the ordinary course of business for certain matters that include the Royalty Properties. While the working interest owner 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 response to Item 1A. to Part 1 of the Trust's Form 10-K for the year ended December 31, 2005.

Edgar Filing: MESA ROYALTY TRUST/TX - Form 10-Q

Item 6. Exhibits.

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

		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)	1-07884	4(c)
4(d)*	Form of Assignment of Overriding Royalty Interest, effective April 1, 1985, from Texas Commerce Bank National Association, as Trustee, to MTR Holding Co. (Exhibit 4(d) to Form 10-K for year ended December 31, 1984 of Mesa Royalty Trust)	1-07884	4(d)
4(e)*	Purchase and Sale Agreement, dated March 25, 1991, by and among Mesa Limited Partnership, Mesa Operating Limited Partnership and Conoco, as amended on April 30, 1991 (Exhibit 4(e) to Form 10-K for year ended December 31, 1991 of Mesa Royalty Trust)	1-07884	4(e)
31	Rule 13a-14(a)/15d-14(a) Certification		
32	Section 1350 Certification		

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.

Mesa Royalty Trust
By: JPMORGAN CHASE BANK, N.A. TRUSTEE

By: **Mike Ulrich**
Vice President & Trust Officer

Date: August 9, 2006

The Registrant, Mesa Royalty Trust, has no principal executive officer, principal financial officer, board of directors or persons performing similar functions. Accordingly, no additional signatures are available and none have been provided.

17
