

TORCH ENERGY ROYALTY TRUST

Form 10-Q

November 14, 2007

**Table of Contents**

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549  
Form 10-Q**

**(Mark One)**

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

**For the quarterly period ended September 30, 2007**

**OR**

**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: 1-12474**

**Torch Energy Royalty Trust**

(Exact Name of Registrant as Specified in Its Charter)

**Delaware**

(State or Other Jurisdiction of  
Incorporation or Organization)

**74-6411424**

(I.R.S. Employer  
Identification Number)

Rodney Square North  
1100 North Market Street, Wilmington, Delaware  
(Address of Principal Executive Offices)

19890  
(Zip Code)

302/636-6016

(Registrant's telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year,  
if changed since last report)

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  Nonaccelerated filer

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 September 30, 2007, 8.6 million Units of Beneficial Interest were outstanding.

---

**TORCH ENERGY ROYALTY TRUST**

**TABLE OF CONTENTS**

**PART I FINANCIAL INFORMATION**

Item I. Financial Statements

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

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Item 4. Controls and Procedures

**PART II. OTHER INFORMATION**

ITEM 1. Legal Proceedings

ITEM 1A. Risk Factors

ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds

ITEM 3. Defaults upon Senior Securities

ITEM 4. Submission of Matters to a Vote of Unitholders

ITEM 5. Other Information

ITEM 6. Exhibits

**SIGNATURES**

**EXHIBIT INDEX**

Certification Pursuant to Section 302

Certification Pursuant to Section 906

---

**Table of Contents**

PART 1 FINANCIAL INFORMATION

**Item I. Financial Statements**

This document includes forward looking statements within the meaning of Section 27A of the Securities Act of 1993, as amended, and Section 21E of the Securities Exchange Act of 1934. All statements other than statements of historical facts included in this document, including without limitation, statements under Discussion and Analysis of Financial Condition and Results of Operations regarding the financial position, reserve quantities and net present values of reserves of the Torch Energy Royalty Trust ( Trust ) and statements that include the words believes , expects , anticipates , intends , estimates , projects , target , goal , plans , objectives , should or similar expressions forward-looking statements. Torch Energy Advisors Incorporated ( Torch ) and the Trust can give no assurances that the assumptions upon which these statements are based will prove to be correct. Factors which could cause such forward looking statements not to be correct include, among others, the cautionary statements set forth in the Trust s Annual Report on Form 10-K and Form 10-K/A filed with the Securities Exchange Commission for the most recent fiscal year, cautionary statements contained in this report, the volatility of oil and gas prices, future production costs, future oil and gas production quantities, operating hazards, and environmental conditions.

**Introduction**

The financial statements included herein have been prepared by Torch, pursuant to an administrative service agreement between Torch and the Trust, pursuant to the rules and regulations of the Securities and Exchange Commission. Wilmington Trust Company serves as the trustee ( Trustee ) of the Trust pursuant to the trust agreement dated October 1, 1993. Certain information and footnote disclosures normally included in the annual financial statements have been omitted pursuant to such rules and regulations, although Torch believes that the disclosures are adequate to make the information presented not misleading. These financial statements should be read in conjunction with the December 31, 2006 financial statements and notes thereto included in the Trust s annual report on Form 10-K and Form 10-K/A for the most recent fiscal year. In the opinion of Torch, all adjustments necessary to present fairly the assets, liabilities and trust corpus of the Trust as of September 30, 2007 and December 31, 2006, the distributable income and changes in trust corpus for the three-month and nine-month periods ended September 30, 2007 and 2006 have been included. All such adjustments are of a normal recurring nature. The distributable income for such interim periods is not necessarily indicative of the distributable income for the full year.

The Trust has no officers, directors or employees. The Trustee relies solely on receiving accurate information, reports and other representations from Torch in the

**Table of Contents**

**TORCH ENERGY ROYALTY TRUST**

ordinary course of its duties as Trustee. In executing and submitting this report on behalf of the Trust and with respect to Bruce L. Bisson in executing the certifications relating to this report, the Trustee and Bruce L. Bisson have relied upon the accuracy of such reports, information and representations of Torch.

Table of Contents

**TORCH ENERGY ROYALTY TRUST**  
**STATEMENTS OF ASSETS, LIABILITIES AND TRUST CORPUS**  
(In thousands)

	September 30, 2007 (Unaudited)	December 31, 2006
<b>ASSETS</b>		
Cash	\$ 1	\$ 1
Net profits interests in oil and gas properties (Net of accumulated amortization of \$163,616 and \$162,215 at September 30, 2007 and December 31, 2006, respectively)	16,984	18,385
	\$ 16,985	\$ 18,386
<b>LIABILITIES AND TRUST CORPUS</b>		
Trust expense payable	\$ 257	\$ 222
Trust corpus	16,728	18,164
	\$ 16,985	\$ 18,386

See notes to financial statements.

Table of Contents

**TORCH ENERGY ROYALTY TRUST**  
**STATEMENTS OF DISTRIBUTABLE INCOME**  
(In thousands, except per Unit amounts)  
(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2007	2006	2007	2006
Net profits income	\$ 1,360	\$ 1,488	\$ 3,600	\$ 6,718
Infill Well Net Proceeds	11		11	516
	1,371	1,488	3,611	7,234
General and administrative expenses	289	240	886	730
Interest expense				81
	289	240	886	811
Distributable income	\$ 1,082	\$ 1,248	\$ 2,725	\$ 6,423
Distributable income per Unit (8,600 Units)	\$ .13	\$ .15	\$ .32	\$ .75
Distributions per Unit	\$ .12	\$ .14	\$ .32	\$ .75

See notes to financial statements

5

---

Table of Contents

**TORCH ENERGY ROYALTY TRUST**  
**STATEMENT OF CHANGES IN TRUST CORPUS**  
(In thousands)  
(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2007	2006	2007	2006
Trust corpus, beginning of period	\$ 17,135	\$ 20,580	\$ 18,164	\$ 21,441
Amortization of Net Profits Interests	(440)	(396)	(1,401)	(1,246)
Distributable income	1,082	1,248	2,725	6,423
Distributions to Unitholders	(1,049)	(1,230)	(2,760)	(6,416)
Trust corpus, end of period	\$ 16,728	\$ 20,202	\$ 16,728	\$ 20,202

See notes to financial statements.

6

---

**Table of Contents**

**TORCH ENERGY ROYALTY TRUST**

Notes to Financial Statements

1. Trust Organization and Nature of Operations

The Trust was formed effective October 1, 1993 under the Delaware Statutory Trust Act pursuant to a trust agreement ( Trust Agreement ) among Trustee, Torch Royalty Company ( TRC ), Velasco Gas Company, Ltd. ( Velasco ), and Torch as grantor. TRC and Velasco created net profits interests ( Net Profits Interests ), which burden certain oil and gas properties ( Underlying Properties ), and conveyed such interests to Torch. Torch conveyed the Net Profits Interests to the Trust in exchange for an aggregate of 8,600,000 units of beneficial interest ( Units ). Pursuant to an administrative services agreement with the Trust, Torch provides accounting, bookkeeping, informational and other services related to the Net Profits Interests.

The Underlying Properties constitute working interests in the Chalkley field in Louisiana ( Chalkley Field ), the Robinson s Bend field in the Black Warrior Basin in Alabama ( Robinson s Bend Field ), fields that produce from the Cotton Valley formations in Texas ( Cotton Valley Fields ) and fields that produce from the Austin Chalk formation in Texas ( Austin Chalk Fields ). The Underlying Properties represent interest in all productive formations from 100 feet below the deepest productive formation in each field to the surface when the Trust was formed. The Trust therefore has no interest in deeper formations.

The Trust will terminate upon the first to occur of (i) an affirmative vote of the holders of not less than 66-2/3% of the outstanding Units to liquidate the Trust; (ii) such time as the ratio of the cash amounts received by the Trust from the Net Profits Interests to administrative costs of the Trust is less than 1.2 to 1.0 for three consecutive quarters; (iii) March 1 of any year if it is determined based on a reserve report as of December 31 of the prior year that the present value of estimated pre-tax future net cash flows, discounted at 10%, of proved reserves attributable to the Net Profits Interests is equal to or less than \$25.0 million; or (iv) December 31, 2012. As of September 30, 2007, the Trust has not terminated, as none of the aforementioned events have occurred. Upon termination of the Trust, the remaining assets of the Trust will be sold and the proceeds therefrom (after expenses) will be distributed to the unitholders ( Unitholders ). The sole purpose of the Trust is to hold the Net Profits Interests, to receive payments from TRC and Velasco, and to make payments to Unitholders. The Trust does not conduct any business activity.

The only assets of the Trust, other than cash and temporary investments being held for the payment of expenses and liabilities and for distribution to Unitholders, are the Net Profits Interests. The Net Profits Interests (other than the Net Profits Interest covering the Robinson s Bend Field) entitle the Trust to receive 95% of the net proceeds ( Net Proceeds ) attributable to oil and gas produced and sold from

**Table of Contents**

**TORCH ENERGY ROYALTY TRUST**

Notes to Financial Statements

wells (other than infill wells) on the Underlying Properties. Net Proceeds are generally defined as gross revenues received from the sale of production attributable to the Underlying Properties during any period less property, production, severance and similar taxes, and development, operating, and certain other costs. In calculating Net Proceeds from the Robinson's Bend Field, operating and development costs incurred prior to January 1, 2003 were not deducted.

In addition, the amounts paid to the Trust from the Robinson's Bend Field during any calendar quarter are subject to a volume limitation ( Volume Limitation ) equal to the gross proceeds from the sale of 912.5 MMcf of gas, less property, production, severance and related taxes and operating and development costs subsequent to January 1, 2003. Since the fourth quarter of 1995, production from the Underlying Properties in the Robinson's Bend Field has been less than the Volume Limitation. See Note 2 to the financial statements for an explanation of the Trust's method of accounting. The Net Profits Interests also entitle the Trust to 20% of the Infill Well Net Proceeds (as defined herein) of wells drilled on the Underlying Properties since the Trust's establishment into formations in which the Trust has an interest, other than wells drilled to replace damaged or destroyed wells ( Infill Wells ). Infill Well Net Proceeds represent the aggregate gross revenues received from Infill Wells less the aggregate amount of the following Infill Well costs: (i) property, production, severance and similar taxes; (ii) development costs; (iii) operating costs; and (iv) interest on the recovered portion, if any, of the foregoing costs computed at the publicly announced base rate of Citibank, N.A. in New York.

The Trust's website address is [www.torchroyalty.com](http://www.torchroyalty.com). The Trust provides access through this website to its annual report on Form 10-K, quarterly reports on Form 10-Q and any current reports on Form 8-K, and all amendments to those reports as soon as reasonably practicable after these reports are filed or furnished electronically with the Securities and Exchange Commission. Information contained on the Trust's website or any other websites is not incorporated by reference into this report and does not constitute a part of this report.

**2. Basis of Accounting**

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

Revenues are recognized in the period in which amounts are received by the Trust. Therefore, revenues recognized during the three-month and nine-month periods ended September 30, 2007 and 2006 are derived from oil and gas production sold during the three-month and nine-month periods ended June 30, 2007 and 2006, respectively. General and administrative expenses are recognized on an accrual basis.

**Table of Contents**

**TORCH ENERGY ROYALTY TRUST**

Notes to Financial Statements

Amortization of the Net Profits Interests is calculated on a unit-of-production basis and charged directly to trust corpus.

Distributions to Unitholders are recorded when declared by the Trustee.

An impairment loss is recognized when the net carrying value of the Net Profits Interests exceeds its fair market value. No impairment loss was recognized during the three-month and nine-month periods ended September 30, 2007 and 2006.

The financial statements of the Trust differ from financial statements prepared in accordance with GAAP because net profits income is not accrued in the period of production and amortization of the Net Profits Interests is not charged against operating results.

Estimates and assumptions have been made in preparing the financial statements of the Trust in order for the financial statements to be in conformity with accounting principles generally accepted in the United States.

**3. Federal Income Taxes**

Tax counsel has advised the Trustee that, under current tax law, the Trust is classified as a grantor trust for Federal income tax purposes. However, the opinion of tax counsel is not binding on the Internal Revenue Service. As a grantor trust, the Trust is not subject to Federal income tax.

Because the Trust is treated as a grantor trust for Federal income tax purposes and a Unitholder is treated as directly owning an interest in the Net Profits Interests, each Unitholder is taxed directly on such Unitholder's pro rata share of income attributable to the Net Profits Interests consistent with the Unitholder's method of accounting and without regard to the taxable year or accounting method employed by the Trust. Amounts payable with respect to the Net Profits Interest is paid to the Trust on the quarterly record date established for quarterly distributions in respect to each calendar quarter during the term of the Trust, and the income and deductions resulting from such payments were allocated to the Unitholders of record on such date.

**4. Distributions and Income Computations**

Distributions are determined for each quarter and are based on the amount of cash available for distribution to Unitholders. Such amount (the Quarterly Distribution Amount) is equal to the excess, if any, of the cash received by the Trust, on the last day of the second month following the previous

**Table of Contents**

**TORCH ENERGY ROYALTY TRUST**

Notes to Financial Statements

calendar quarter (or the next business day thereafter) ending prior to the dissolution of the Trust, from the Net Profits Interests then held by the Trust plus, with certain exceptions, any other cash receipts of the Trust during such quarter, subject to adjustments for changes made during such quarter in any cash reserves established for the payment of contingent or future obligations of the Trust. Based on the payment procedures relating to the Net Profits Interests, cash received by the Trust on the last day of the second month of a particular quarter from the Net Profits Interests generally represents proceeds from the sale of oil and gas produced from the Underlying Properties during the preceding calendar quarter. The Quarterly Distribution Amount for each quarter is payable to Unitholders of record on the last day of the second month of the calendar quarter unless such day is not a business day in which case the record date is the next business day thereafter. The Quarterly Distribution Amount is distributed within approximately ten days after the record date to each person who was a Unitholder of record on the associated record date.

5. Related Party Transactions

*Marketing Arrangements*

TRC and Velasco contracted to sell the oil and gas production from the Underlying Properties to Torch Energy Marketing, Inc. ( *TEMI* ), a subsidiary of Torch, under a purchase contract ( *Purchase Contract* ). Under the Purchase Contract, TEMI is obligated to purchase all net production attributable to the Underlying Properties for an index price for oil and gas ( *Index Price* ), less certain gathering, treating and transportation charges, which are calculated monthly. The Index Price equals 97% of the average spot market prices of oil and gas ( *Average Market Prices* ) at the four locations where TEMI sells production.

The Purchase Contract also provides that the minimum price paid by TEMI for gas production is \$1.70 per MMBtu adjusted annually for inflation ( *Minimum Price* ). When TEMI pays a purchase price based on the Minimum Price, it receives price credits ( *Price Credits* ), equal to the difference between the Index Price and the Minimum Price that it is entitled to deduct in determining the purchase price when the Index Price for gas exceeds the Minimum Price. No Price Credits were deducted in calculating the purchase price related to distributions received by Unitholders during the three-month and nine-month periods ended September 30, 2007 and 2006. As of September 30, 2007, TEMI had no accumulated Price Credits.

In addition, if the Index Price for gas exceeds \$2.10 per MMBtu adjusted annually for inflation ( *Sharing Price* ), TEMI is entitled to deduct 50% of such excess ( *Price Differential* ) in calculating the purchase price. As a result of such Sharing Price arrangement, Net Proceeds attributable to the Underlying Properties during the nine months ended September 30, 2007 and 2006 were reduced by \$5.6 million and \$9.3 million, respectively. TEMI has an annual option to discontinue the Minimum Price

**Table of Contents**

**TORCH ENERGY ROYALTY TRUST**

Notes to Financial Statements

commitment. However, if TEMI discontinues the Minimum Price commitment, it will no longer be entitled to deduct the Price Differential in calculating the purchase price and will forfeit all accrued Price Credits. TEMI has not exercised its option to discontinue the Minimum Price commitment. The Minimum Price for Underlying Property production is adjusted annually for inflation and is \$1.83 per MMBtu for 2007 production and was \$1.80 per MMBtu for 2006 production. The Sharing Price for Underlying Property production is \$2.26 per MMBtu for 2007 production and was \$2.22 per MMBtu for 2006 production.

Gross revenues (before deductions for applicable gathering, treating and transportation charges) from TEMI included in the Net Proceeds calculations attributable to the Underlying Properties during the three months ended September 30, 2007 and 2006 were \$4.4 million and \$4.2 million, respectively. Such gross revenues for the nine-month periods ended September 30, 2007 and 2006 were \$12.8 million and \$17.2 million, respectively.

*Gathering, Treating and Transportation Arrangements*

The Purchase Contract entitles TEMI to deduct certain gas gathering, treating and transportation costs in calculating the purchase price for gas in the Robinson s Bend, Austin Chalk and Cotton Valley Fields. The amounts that may be deducted in calculating the purchase price for such gas are set forth in the Purchase Contract and are not affected by the actual costs incurred by TEMI to gather, treat and transport gas. In the Robinson s Bend Field, TEMI is entitled to deduct a gathering, treating and transportation fee of \$0.26 per MMBtu adjusted for inflation (\$0.308 and \$0.303 per MMBtu for 2007 and 2006 production, respectively), plus fuel usage equal to 5% of revenues pursuant to a gas gathering agreement. Additionally, a fee of \$0.05 per MMBtu, representing a gathering fee payable to a non-affiliate of TEMI, is deducted in calculating the purchase price for production from 68 of 394 wells in the Robinson s Bend Field. TEMI also deducts \$0.38 per MMBtu plus 17% of revenues in calculating the purchase price for production from the Austin Chalk Fields, as a fee to gather, treat and transport gas production. From the purchase price for gas in the Cotton Valley Fields, TEMI deducts a transportation fee of \$0.045 per MMBtu for production attributable to certain wells. This transportation fee is paid to a third party. During the three months ended September 30, 2007 and 2006, such fees deducted from the Net Proceeds calculations, attributable to production during the three months ended June 30, 2007 and 2006, in the Robinson s Bend, Austin Chalk and Cotton Valley Fields, totaled \$0.4 million and \$0.3 million, respectively. During the nine months ended September 30, 2007 and 2006, such fees deducted from the Net Proceeds calculations, attributable to production during the nine months ended September 30, 2007 and 2006, in the Robinson s Bend, Austin Chalk and Cotton Valley Fields, totaled \$1.1 million and \$1.4 million, respectively. No amounts for gathering, treating or transportation are deducted in calculating the purchase price from the Chalkley Field.

**Table of Contents**

**TORCH ENERGY ROYALTY TRUST**

Notes to Financial Statements

*Administrative Services Agreement*

Pursuant to the Trust Agreement, Torch and the Trust entered into an administrative services agreement effective October 1, 1993. The Trust is obligated, throughout the term of the Trust, to pay to Torch each quarter an administrative services fee for accounting, bookkeeping, informational and other services relating to the Net Profits Interests. The amount of the administrative services fee is adjusted annually based upon the change in the Producer's Price Index as published by the Department of Labor, Bureau of Labor Statistics. Administrative services during the three months ended September 30, 2007 and 2006 were \$104,000 and \$102,000, respectively. During the nine months ended September 30, 2007 and 2006, such fees were \$311,000 and \$305,000 respectively.

*Operator Overhead Fees*

A subsidiary of Torch operates certain oil and gas interests burdened by the Net Profits Interests. The Underlying Properties are charged, on the same basis as other third parties, for all customary expenses and costs reimbursements associated with these activities. Operator overhead fees deducted from the Net Proceeds computations for the Chalkley, Cotton Valley and Austin Chalk Fields totaled \$51,000 and \$48,000, respectively, for the three months ended September 30, 2007 and 2006. During the nine months ended September 30, 2007 and 2006, such operator overhead fees were \$149,000 and \$145,000, respectively.

*Compensation of the Trustee and Transfer Agent*

The Trust Agreement provides that the Trustee is compensated for its administrative services, out of the Trust assets, in an annual amount of \$80,000, plus an hourly charge for services in excess of a combined total of 250 hours annually at its standard rate. The Trustee is also entitled to reimbursement for out-of-pocket expenses. Additionally, the Trustee receives a transfer agency fee of \$5.00 annually per account (minimum of \$15,000 annually), subject to change for inflation each December, based upon the change in the Producer's Price Index as published by the Department of Labor, Bureau of Labor Statistics, plus \$1.00 for each certificate issued. Total administrative and transfer agent fees for each period during the three months ended September 30, 2007 and 2006 were \$24,000. Such fees for each period during the nine months ended September 30, 2007 and 2006 were \$71,000.

**Table of Contents**

**TORCH ENERGY ROYALTY TRUST**

Notes to Financial Statements

**6. Tender Offer and Request for Special Meeting of Unitholders to Terminate the Trust**

On May 10, 2007, Trust Venture Company, LLC ( Trust Venture ) announced that it had commenced a tender offer for any and all of the outstanding Units of the Trust (the Tender Offer ). The Tender Offer expired on June 28, 2007 with Trust Venture announcing that it had purchased 2,360,664 Units (approximately 31% of the outstanding Units) for \$8.25 per Unit.

On August 1, 2007, the Trust reported that it had received and verified a request by Trust Venture to the Trustee to call a special meeting of the Unitholders. This request for a special meeting was issued pursuant to Section 8.02 of the Trust Agreement, by and among Torch, TRC, Velasco and the Trustee, dated October 1, 1993. Section 8.02 of the Trust Agreement permits Unitholders owning of record 10% or more in number of the then outstanding units of the Trust to call a special meeting of Unitholders. Trust Venture stated the purpose of such special meeting was to consider and vote upon a proposal to terminate the Trust in accordance with the applicable provisions of the Trust Agreement.

The Trust filed a Preliminary Information Statement on Schedule 14C on October 15, 2007 with the Securities and Exchange Commission regarding the special meeting of the Unitholders. In November 2007, Trust Venture requested that the Trust postpone the filing of the Definitive Information Statement with the Securities and Exchange Commission and the mailing of the notice of special meeting and information statement relating thereto while Trust Venture evaluates opportunities relating to its investment in the Trust. Trust Venture informed the Trust on November 14, 2007 that it is revoking its request for a special meeting of the Unitholders.

**7. State Tax Considerations**

The Texas legislature recently passed H.B. 3, 79th Leg., 3d C.S. (2006), which was signed into law on May 18, 2006. H.B. 3 significantly reforms the Texas franchise tax system and replaces it with a new Texas margin system and implements a new margin tax of 1% to be imposed on revenues less certain costs, as specified in the legislation, generated from Texas activities beginning in 2007.

Trusts and partnerships that meet statutory requirements and receive at least 90% of their gross income from designated sources, including royalties from mineral properties, and do not receive more than 10% of their income from operating an active trade or business, are generally exempt from the margin tax as passive entities . Although the income of the Trust consists primarily of royalty income from the sale of natural gas and crude oil, there is no clear authority that the Trust satisfies all the margin tax statutory requirements for the exemption for passive entities to apply. Therefore, prior to clarification by additional legislative action or the issuance of applicable administrative rules promulgated by the Texas Comptroller, it is uncertain whether the Trust would be exempt from the margin tax as a passive entity or subject to the margin tax at the Trust level.

The Trust does not currently intend to pay the margin tax, based on the assumption that it is exempt as a passive entity. However, if it is subsequently determined that the Trust is not exempt from the margin tax, the Trust would be required to deduct and withhold from future distributions the amounts necessary to pay the margin tax for the entire 2007 year, including the tax liability accruing on income distributed

**Table of Contents****TORCH ENERGY ROYALTY TRUST**

after January 2007 from which no tax was withheld. Approximately 60% of the Trust's net profits income is generated from Underlying Properties in Texas.

If the Trust is exempt from the margin tax at the Trust level as a passive entity, each Unitholder that is a taxable entity would generally include its share of the Trust's revenues in its margin tax computation. If, however, the margin tax is imposed on the Trust at the Trust level, each Unitholder would generally exclude its share of the Trust's net income from the margin tax calculation. Unitholders should consult their own tax advisors regarding their individual tax situation and the requirements for filing state income, franchise and margin tax returns.

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

Because a modified cash basis of accounting is utilized by the Trust, Net Proceeds attributable to the Underlying Properties for the three months ended September 30, 2007 and 2006 is derived from actual oil and gas produced during the three months ended June 30, 2007 and 2006, respectively. Net Proceeds attributable to the Underlying Properties for the nine months ended September 30, 2007 and 2006 is derived from oil and gas produced during the nine months ended June 30, 2007 and 2006, respectively. Oil and gas sales attributable to the Underlying Properties for such periods are as follows:

	Three Months Ended September 30,			
	2007		2006	
	Bbls of Oil	Mcf of Gas	Bbls of Oil	Mcf of Gas
Chalkley Field	1,049	239,122	1,024	270,463
Robinson's Bend Field		410,302		428,437
Cotton Valley Fields	420	159,820	393	147,007
Austin Chalk Fields	1,628	38,387	2,528	43,156
	3,097	847,631	3,945	889,063

	Nine Months Ended September 30,			
	2007		2006	
	Bbls of Oil	Mcf of Gas	Bbls of Oil	Mcf of Gas
Chalkley Field	3,146	745,301	3,450	853,698
Robinson's Bend Field		1,258,375		1,316,530
Cotton Valley Fields	1,336	483,204	1,170	472,718
Austin Chalk Fields	7,538	148,403	9,240	144,080
	12,020	2,635,283	13,860	2,787,026

**Table of Contents**

**TORCH ENERGY ROYALTY TRUST**

**Three Months Ended September 30, 2007 Compared to Three Months Ended September 30, 2006**

For the three months ended September 30, 2007, net profits income was \$1.4 million, down 7% from net profits income of \$1.5 million for the same period in 2006. Such decrease is mainly attributable to an increase in costs and expenses deducted from Net Proceeds payable to the Trust during the three months ended September 30, 2007, partially offset by higher oil and gas prices paid to the Trust during the quarter ended September 30, 2007.

Gas production attributable to the Underlying Properties in the Chalkley, Cotton Valley and Austin Chalk Fields was 437,329 Mcf and 460,626 Mcf during the three months ended June 30, 2007 and 2006, respectively. Gas production attributable to the Underlying Properties in the Robinson s Bend Field was 410,302 Mcf and 428,437 Mcf during the three months ended June 30, 2007 and 2006, respectively. Oil production attributable to the Underlying Properties for the three months ended June 30, 2007 and 2006 was 3,097 Bbls and 3,945 Bbls, respectively. Gas and oil production decreased during 2007 as a result of normal production declines

During the three months ended September 30, 2007, the average price used to calculate Net Proceeds for gas, before gathering, treating and transportation deductions, was \$4.74 per MMBtu as compared to \$4.31 per MMBtu for the three months ended September 30, 2006. During the three months ended September 30, 2007, the average price used to calculate Net Proceeds for oil was \$67.92 as compared to \$63.95 per Bbl for the quarter ended September 30, 2006. When TEMI pays a purchase price for gas based on the Minimum Price (\$1.83 per MMBtu and \$1.80 per MMBtu for 2007 and 2006 production, respectively), TEMI receives Price Credits which it is entitled to deduct in determining the purchase price when the Index Price for gas exceeds the Minimum Price. No Price Credits were deducted in calculating the purchase price related to distributions received by Unitholders during the three months ended June 30, 2007 and 2006. As of September 30, 2007, TEMI had no accumulated Price Credits. Additionally, if the Index Price for gas exceeds the Sharing Price (\$2.26 per MMBtu and \$2.22 per MMBtu for 2007 and 2006 production, respectively), TEMI is entitled to deduct 50% of such excess in calculating the purchase price. The deduction of the Price Differential in calculating the purchase price had the effect of reducing distributions received by Unitholders during the three-month periods ended September 30, 2007 and 2006 by \$2.1 million and \$1.8 million, respectively. The Trust received no payments with respect to the Robinson s Bend Field during the three months ended September 30, 2007 and 2006. In calculating the Robinson s Bend Field Net Proceeds pertaining to production during the three months ended June 30, 2007, gross revenues exceeded costs and expenses by approximately \$86,000. However, the Trust will receive no payments with respect to the Robinson s Bend Field until future proceeds exceed the sum of future costs and expenses and the cumulative excess of such costs and expenses, including interest ( Robinson s Bend Deficit ). The Trust does not anticipate that the Net Proceeds attributable to the Robinson s Bend Field, if any, will be significant in the future. As of September 30, 2007 (pertaining to production through June 30, 2007), the Robinson s Bend Cumulative Deficit was approximately \$76,000.

**Table of Contents**

**TORCH ENERGY ROYALTY TRUST**

During the three months ended September 30, 2007, the Trust distributed approximately \$11,000 of Infill Well Net Proceeds pertaining to oil and gas sales during the three months ended March 31, 2007. During the three months ended September 30, 2006, the Trust received no payments with respect to the Infill Wells since costs and expenses exceeded gross revenues generated from the Infill Wells. Such Infill Wells are located in the Cotton Valley Fields and are operated by Samson Lone Star Limited Partnership.

Lease operating expenses and capital expenditures attributable to the Underlying Properties in the Chalkley, Cotton Valley and Austin Chalk Fields deducted in calculating distributions during the three months ended September 30, 2007 and 2006 totaled \$0.7 million and \$0.5 million, respectively. With respect to the Robinsons Bend Field, lease operating expenses and capital expenditures of \$1.5 million and \$1.7 million were deducted in calculating the Net Proceeds payable to the Trust from the Robinsons Bend Field for the three month ended September 30, 2007 and 2006, respectively.

General and administrative expenses amounted to \$0.3 million and \$0.2 million, respectively, for the three months ended September 30, 2007 and 2006. General and administrative expenses primarily relate to administrative services provided by Torch and the Trustee, and legal fees.

The foregoing resulted in distributable income of \$1.1 million, or \$0.13 per Unit, for the three months ended September 30, 2007, as compared to \$1.2 million, or \$0.15 per Unit, for the same period in 2006. Cash distributions of \$1.0 million, or \$0.12 per Unit, were made during the three months ended September 30, 2007 as compared to \$1.2 million, or \$0.14 per Unit, for the same period in 2006.

**Nine Months Ended September 30, 2007 Compared to Nine Months Ended September 30, 2006**

For the nine months ended September 30, 2007, net profits income was \$3.6 million, down 46% from net profits income of \$6.7 million for the same period in 2006. Such decrease is mainly attributable to lower oil and gas prices paid to the Trust during the nine months ended September 30, 2007 combined with decreases in oil and gas production paid to the Trust during the nine months ended September 30, 2007. A decline in the Net Proceeds generated from the Robinsons Bend Field during the nine months ended September 30, 2007 also contributed to the decline in net profits income.

Gas production attributable to the Underlying Properties in the Chalkley, Cotton Valley and Austin Chalk Fields was 1,376,908 Mcf and 1,470,496 Mcf during the nine months ended June 30, 2007 and 2006, respectively. Gas production attributable to the Underlying Properties in the Robinsons Bend Field was 1,258,375 Mcf and 1,316,530 Mcf during the nine months ended June 30, 2007 and 2006, respectively. Oil production attributable to the Underlying Properties for the nine months ended June 30, 2007 and 2006 was 12,020 Bbls and 13,860 Bbls, respectively. Gas and oil production decreased during 2007 mainly as a result of normal production declines.

During the nine months ended September 30, 2007, the average price used to calculate Net Proceeds for gas, before gathering, treating and transportation deductions, was \$4.42 per MMBtu as compared to \$5.63 per MMBtu for the nine months ended September 30, 2006. During the nine months ended

**Table of Contents**

**TORCH ENERGY ROYALTY TRUST**

September 30, 2007, the average price used to calculate Net Proceeds for oil was \$55.52 as compared to \$57.24 per Bbl for the nine months ended September 30, 2006. When TEMI pays a purchase price for gas based on the Minimum Price (\$1.83 per MMBtu and \$1.80 per MMBtu for 2007 and 2006 production, respectively), TEMI receives Price Credits which it is entitled to deduct in determining the purchase price when the Index Price for gas exceeds the Minimum Price. No Price Credits were deducted in calculating the purchase price related to distributions received by Unitholders during the nine-month periods ended September 30, 2007 and 2006. As of September 30, 2007, TEMI had no accumulated Price Credits. Additionally, if the Index Price for gas exceeds the Sharing Price (\$2.26 per MMBtu and \$2.22 per MMBtu for 2007 and 2006 production, respectively), TEMI is entitled to deduct 50% of such excess in calculating the purchase price. The deduction of the Price Differential in calculating the purchase price had the effect of reducing distributions received by Unitholders during the nine months ended September 30, 2007 and 2006 by \$5.6 million and \$9.3 million, respectively.

The Trust received no payments with respect to the Robinson s Bend Field during the nine months ended September 30, 2007. In calculating the Robinson s Bend Field Net Proceeds pertaining to production during the nine months ended June 30, 2007, costs and expenses exceeded revenues by approximately \$70,000. Neither the Trust nor the Unitholders are liable to pay such deficit. However, the Trust will receive no payments with respect to the Robinson s Bend Field until future proceeds exceed the Robinson s Bend Deficit. The Trust does not anticipate that the Net Proceeds attributable to the Robinson s Bend Field, if any, will be significant in the future. As of September 30, 2007 (pertaining to production through June 30, 2007), the Robinson s Bend Cumulative Deficit was approximately \$76,000. During the nine months ended September 30, 2006, the Trust distributed approximately \$547,000 (net of interest expense) of Net Proceeds generated from the Net Profits Interests pertaining to the Robinson s Bend Field. During the nine months ended September 30, 2007 and 2006, the Trust distributed approximately \$11,000 and \$516,000, respectively, of Infill Well Net Proceeds pertaining to oil and gas sales during the nine months ended March 31, 2007 and 2006, respectively. The decline in Infill Well Net Proceeds during 2007 is mainly due to capital expenditures pertaining to additional wells that were drilled in the current period. Such Infill Wells are located in the Cotton Valley Fields and are operated by Samson Lone Star Limited Partnership.

Lease operating expenses and capital expenditures attributable to the Underlying Properties in the Chalkley, Cotton Valley and Austin Chalk Fields deducted in calculating distributions during the nine months ended September 30, 2007 and 2006 totaled \$2.3 million and \$2.0 million, respectively. With respect to the Robinsons Bend Field, lease operating expenses and capital expenditures of \$4.6 million and \$4.9 million were deducted in calculating the Net Proceeds payable to the Trust from the Robinson s Bend Field during the nine months ended September 30, 2007 and 2006, respectively.

General and administrative expenses amounted to \$0.9 million and \$0.7 million for the nine months ended September 30, 2007 and 2006, respectively. These expenses primarily relate to administrative services provided by Torch and the Trustee and legal fees. The increase in general and administrative

**Table of Contents**

**TORCH ENERGY ROYALTY TRUST**

costs in 2007 is mainly due to legal fees and printing costs incurred by the Trust during the nine months ended September 30, 2007 in connection with the Tender Offer (see footnote 6).

The foregoing resulted in distributable income of \$2.7 million, or \$.32 per Unit, for the nine months ended September 30, 2007, as compared to \$6.4 million, or \$.75 per Unit, for the same period in 2006. Cash distributions of \$2.8 million, or \$0.32 per Unit, were made during the nine months ended September 30, 2007 as compared to \$6.4 million, or \$0.75 per Unit, for the same period in 2006.

**Table of Contents****TORCH ENERGY ROYALTY TRUST**

Net profits income received by the Trust during the three and nine month periods ended September 30, 2007 and 2006, derived from production sold during the three and nine months ended June 30, 2007 and 2006, respectively, was computed as shown in the following table (in thousands):

	<b>Three Months Ended September 30, 2007</b>			<b>Three Months Ended September 30, 2006</b>		
	<b>Chalkley, Cotton Valley and Austin Chalk Fields</b>	<b>Robinson s Bend Field</b>	<b>Total</b>	<b>Chalkley, Cotton Valley and Austin Chalk Fields</b>	<b>Robinson s Bend Field</b>	<b>Total</b>
Oil and gas revenues	\$ 2,275	\$ 1,726	\$ 4,001	\$ 2,227	\$ 1,636	\$ 3,863
Direct operating expenses:						
Lease operating expenses and property tax	526	1,545	2,071	480	1,551	2,031
Severance tax	183	156	339	172	138	310
	709	1,701	2,410	652	1,689	2,341
Net proceeds before capital expenditures	1,566	25	1,591	1,575	(53)	1,522
Capital expenditures	134	(61)	73	9	137	146
Net proceeds	1,432	86	1,518	1,566	(190)	1,376
Net profits percentage	95%			95%		
Net profits income	\$ 1,360	\$	\$ 1,360	\$ 1,488	\$	\$ 1,488

	<b>Nine Months Ended September 30, 2007</b>			<b>Nine Months Ended September 30, 2006</b>		
	<b>Chalkley, Cotton Valley and Austin Chalk Fields</b>	<b>Robinson s Bend Field</b>	<b>Total</b>	<b>Chalkley, Cotton Valley and Austin Chalk Fields</b>	<b>Robinson s Bend Field</b>	<b>Total</b>
Oil and gas revenues	\$ 6,691	\$ 4,929	\$ 11,620	\$ 9,062	\$ 6,620	\$ 15,682

Direct operating expenses:

Edgar Filing: TORCH ENERGY ROYALTY TRUST - Form 10-Q

Lease operating expenses and property tax	1,754	4,545	6,299	1,590	4,566	6,156
Severance tax	591	441	1,032	642	647	1,289
	2,345	4,986	7,331	2,232	5,213	7,445
Net proceeds before capital expenditures	4,346	(57)	4,289	6,830	1,407	8,237
Capital expenditures	557	13	570	420	363	783
Cumulative Deficit	3,789	(70)	3,719	6,410	1,044 (574)	7,454 (574)
Net proceeds	3,789	(70)	3,719	6,410	470	6,880
Net profits percentage	95%			95%		
Net profits income	\$ 3,600	\$	\$ 3,600	\$ 6,090	\$ 628	\$ 6,718

**Table of Contents**

**TORCH ENERGY ROYALTY TRUST**

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

The Trust is exposed to market risk, including adverse changes in commodity prices. The Trust's assets constitute Net Profits Interests in the Underlying Properties. As a result, the Trust's operating results can be significantly affected by fluctuations in commodity prices caused by changing market forces and the price received for production from the Underlying Properties.

All production from the Underlying Properties is sold pursuant to a Purchase Contract between TRC, Velasco and TEMI. Pursuant to the Purchase Contract, TEMI is obligated to purchase all net production attributable to the Underlying Properties for an Index Price, less certain other charges, which are calculated monthly. The Index Price calculation is based on market prices of oil and gas and therefore is subject to commodity price risk. The Purchase Contract provides a Minimum Price paid by TEMI for gas. The Minimum Price is adjusted annually for inflation and is \$1.83 per MMBtu for 2007 production and was \$1.80 per MMBtu for 2006 production. When TEMI pays a purchase price based on the Minimum Price, it receives Price Credits equal to the difference between the Index Price and the Minimum Price that it is entitled to deduct when the Index Price exceeds the Minimum Price. Additionally, if the Index Price exceeds the Sharing Price, TEMI is entitled to deduct such excess, the Price Differential. The Sharing Price is \$2.26 per MMBtu for 2007 production and was \$2.22 per MMBtu for 2006 production. The Purchase Contract expires upon termination of the Trust. Accordingly, when the Trust terminates, the working interest owners of the Underlying Properties are no longer obligated to sell the gas produced from the Underlying Properties pursuant to the Purchase Contract. Notwithstanding the termination of the Purchase Contract, the Trust believes that the Net Profits Interest will continue to burden the Underlying Properties for their remaining life and will continue to be calculated as if the Purchase Contract was still in effect, regardless of what proceeds may actually be received by the working interest owners as the seller of the gas. TEMI has an annual option to discontinue the Minimum Price commitment. However, if TEMI discontinues the Minimum Price commitment, it will no longer be entitled to deduct the Price Differential and will forfeit all accrued Price Credits. TEMI has not exercised its option to discontinue the Minimum Price Commitment.

**Table of Contents**

**TORCH ENERGY ROYALTY TRUST**

**Item 4. Controls and Procedures**

Based on their evaluation as of the end of the period covered by this quarterly report on Form 10-Q, the Trustee has concluded that the Trust's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities and Exchange Act of 1934) were effective as of the end of the period covered by this quarterly report on Form 10-Q. In its evaluation of disclosure controls and procedures, the Trustee has relied, to the extent considered reasonable, on information provided by Torch.

There were no significant changes in the Trust's internal control over financial reporting during the Trust's last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Trust's internal control over financial reporting.

**PART II. OTHER INFORMATION**

**ITEM 1. Legal Proceedings**

None.

**ITEM 1A. Risk Factors**

The risk factors from our annual report on Form 10-K and Form 10-K/A are supplemented by the following:

***If it is determined that the Trust is subject to the Texas margin tax, the Trustee may have to withhold a disproportionate amount from future distributions to pay the tax liability.***

The Trustee does not intend to pay any amounts for the new Texas margin tax for tax year 2007, based on the assumption that the Trust is exempt from tax as a passive entity; however, there is currently no clear statutory authority that the Trust meets requirements for the margin tax exemption as a passive entity. If it is subsequently determined that the Trust is not exempt from the margin tax, the Trust would be required to deduct and withhold from future distributions the amounts necessary to pay the margin tax for the entire 2007 year, including the tax liability accruing on income distributed after December 2006 attributable to 2007 Trust revenues from which no tax was withheld. For more information about the Texas margin tax, see Note 7 to the Trust's financial statements.

**Table of Contents**

**TORCH ENERGY ROYALTY TRUST**

**If the Trust terminates there is no assurance that the Trustee can sell the Net Profits Interests at all or that the Net Profits Interests will be sold for a certain amount.**

The Trust will terminate on March 1 of any year if it is determined that the pre-tax future net cash flows, discounted at 10%, attributable to the estimated net proved reserves of the Net Profits Interests on the preceding December 31 are less than \$25.0 million. The pre-tax future net cash flows, discounted at 10%, attributable to estimated net proved reserves of the Net Profits Interests as of December 31, 2006 was approximately \$26.4 million. Such reserve report was prepared pursuant to Securities and Exchange Commission guidelines and utilized an unescalated Purchase Contract price (after gathering, treating and transportation fees) of \$4.06 per Mcf. The computation of the \$4.06 per Mcf Purchase Contract price was based on an unescalated Henry Hub spot price for natural gas on December 31, 2006 of \$5.64 per MMBtu. The December 31, 2006 reserve value was greater than \$25.0 million. Therefore, the Trust did not terminate as of March 1, 2007.

In preparing the reserve report, the Purchase Contract Price was utilized for the life of the Underlying Properties because the Trust believes that the Net Profits Interest will continue to burden the Underlying Properties for their remaining life and will continue to be calculated as if the Purchase Contract was still in effect.

In addition, the Trust terminates upon an affirmative vote of the holders of not less than 66-2/3% of the then outstanding Units. In accordance with the provisions of the Trust Agreement, Trust Venture has requested that the Trustee call a meeting of the Unitholders to consider a proposal to terminate the Trust (see footnote 6). Due to limitations in the Trust Agreement and the other governing documents, neither the Trust nor Trustee is able to take positions on the value of the Units, including making recommendations in a tender offer or in connection with a Unitholder vote to terminate the Trust and are limited in this regard. Upon termination of the Trust, Article IX of the Trust Agreement requires that the Trustee sell the Net Profits Interests. The Trustee shall continue to act as the trustee of the estate of the Trust after termination and shall exercise the powers granted under the Trust Agreement until its duties have been fully performed and the estate of the Trust finally distributed so that the affairs of the Trust may be liquidated and wound up. No assurances can be given that the Trustee will be able to sell the Net Profits Interests, or the amounts that will be available to be distributed to Unitholders following such a sale. Such distributions could be below the market price of the Units. Upon making final distribution to the Unitholders and cancellation of the Trust, the Trustee shall not be under any further liability under the Trust Agreement.

**ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds**

None.

**Table of Contents**

**TORCH ENERGY ROYALTY TRUST**

**ITEM 3. Defaults upon Senior Securities**

None.

**ITEM 4. Submission of Matters to a Vote of Unitholders**

None.

**ITEM 5. Other Information**

None

**ITEM 6. Exhibits**

(a) Exhibits

4. Instruments of defining the rights of security holders, including indentures.

4.1 Form of Torch Energy Royalty Trust Agreement. \*

4.2 Form of Louisiana Trust Agreement. \*

4.3 Specimen Trust Unit Certificate. \*

4.4 Designation of Ancillary Trustee. \*

31.1 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

\* Incorporated by reference from Registration Statements on Form S-1 of Torch Energy Advisors Incorporated (Registration No. 33-68688) dated November 16, 1993.

**Table of Contents**

**TORCH ENERGY ROYALTY TRUST  
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.

TORCH ENERGY ROYALTY TRUST

By: Wilmington Trust Company,  
not in its individual capacity but solely as  
Trustee for the Trust

By: /s/ Bruce L. Bisson

Bruce L. Bisson  
Vice President

Date: November 14, 2007

(The Trust has no employees, directors or executive officers.)

**Table of Contents**

EXHIBIT INDEX

- 4.1 Form of Torch Energy Royalty Trust Agreement. \*
- 4.2 Form of Louisiana Trust Agreement. \*
- 4.3 Specimen Trust Unit Certificate. \*
- 4.4 Designation of Ancillary Trustee. \*
- 31.1 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

\* Incorporated by reference from Registration Statements on Form S-1 of Torch Energy Advisors Incorporated (Registration No. 33-68688) dated November 16, 1993.