

MESA ROYALTY TRUST/TX
Form 10-Q
August 21, 2009

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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended September 30, 2008

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

For the Transition Period from _____ to _____
Commission File Number: **1-7884**

MESA ROYALTY TRUST

(Exact Name of Registrant as Specified in its Charter)

Texas

(State or other Jurisdiction of
Incorporation or Organization)

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

(Address of Principal Executive Offices)

76-6284806

(I.R.S. Employer
Identification No.)

78701

(Zip Code)

1-800-852-1422

(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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a

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smaller reporting
company)

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

As of August 21, 2009 1,863,590 Units of Beneficial Interest were outstanding in Mesa Royalty Trust.

PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

MESA ROYALTY TRUST
STATEMENTS OF DISTRIBUTABLE INCOME

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Royalty income	\$ 4,535,119	\$ 3,180,214	\$ 10,896,240	\$ 8,406,218
Interest income	10,840	24,883	36,834	69,374
General and administrative expense	(35,801)	(18,062)	(96,075)	(64,904)
Distributable income	\$ 4,510,158	\$ 3,187,035	\$ 10,836,999	\$ 8,410,688
Distributable income per unit	\$ 2.4201	\$ 1.7102	\$ 5.8151	\$ 4.5132
Units outstanding	1,863,590	1,863,590	1,863,590	1,863,590

STATEMENTS OF ASSETS, LIABILITIES AND TRUST CORPUS

	September 30, 2008	December 31, 2007
	(Unaudited)	
ASSETS		
Cash and short-term investments	\$ 4,499,318	\$ 3,783,453
Interest receivable	10,840	27,904
Net overriding royalty interest in oil and gas properties	42,498,034	42,498,034
Accumulated amortization	(35,254,645)	(34,805,821)
Total assets	\$ 11,753,547	\$ 11,503,570
LIABILITIES AND TRUST CORPUS		
Distributions payable	\$ 4,510,158	\$ 3,811,357
Trust corpus (1,863,590 units of beneficial interest authorized and outstanding)	7,243,389	7,692,213
Total liabilities and trust corpus	\$ 11,753,547	\$ 11,503,570

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

MESA ROYALTY TRUST

STATEMENTS OF CHANGES IN TRUST CORPUS

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Trust corpus, beginning of period	\$ 7,403,895	\$ 7,910,943	\$ 7,692,213	\$ 8,102,715
Distributable income	4,510,158	3,187,035	10,836,999	8,410,688
Distributions to unitholders	(4,150,158)	(3,187,035)	(10,836,999)	(8,410,688)
Amortization of net overriding royalty interest	(160,506)	(73,211)	(448,824)	(264,983)
Trust corpus, end of period	\$ 7,243,389	\$ 7,837,732	\$ 7,243,389	\$ 7,837,732

(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. On that date, Mesa Petroleum Co., predecessor to Mesa Limited Partnership ("MLP"), which was the predecessor to MESA Inc., conveyed to the Trust an overriding royalty interest (the "Royalty") equal to 90% of the Net Proceeds (as defined in the Conveyance and described below) attributable to the specified interests in properties conveyed by the assignor on that date (the "Subject Interests"). The Subject Interests consisted of interests in certain producing oil and gas properties located in the Hugoton field of Kansas, the San Juan Basin field of New Mexico and Colorado and the Yellow Creek field of Wyoming (the "Royalty Properties"). The Royalty is evidenced by counterparts of an Overriding Royalty Conveyance dated as of November 1, 1979 (the "Conveyance"). On April 30, 1991, MLP sold its interests in the Royalty Properties located in the San Juan Basin field to ConocoPhillips. ConocoPhillips sold most of its interests in the San Juan Basin Royalty Properties located in Colorado to MarkWest Energy Partners, Ltd. (effective January 1, 1993) and Red Willow Production Company (effective April 1, 1992). On October 26, 1994, MarkWest Energy Partners, Ltd. sold substantially all of its interest in the Colorado San Juan Basin Royalty Properties to BP Amoco Company ("BP"), a subsidiary of BP p.l.c. Until August 7, 1997, MESA Inc. operated the Hugoton Royalty Properties through Mesa Operating Co., a wholly owned subsidiary of MESA Inc. On August 7, 1997, MESA Inc. merged with and into Pioneer Natural Resources Company ("Pioneer"), formerly a wholly owned subsidiary of MESA Inc., and Parker & Parsley Petroleum Company merged with and into Pioneer Natural Resources USA, Inc. (successor to Mesa Operating Co.), a wholly owned subsidiary of Pioneer ("PNR") (collectively, the mergers are referred to herein as the "Merger"). Subsequent to the Merger, the Hugoton Royalty Properties have been operated by PNR. The San Juan Basin Royalty Properties located in New Mexico are operated by ConocoPhillips. The San Juan Basin Royalty Properties located in Colorado are operated by BP. As used in this report, PNR refers to the operator of the Hugoton Royalty Properties, ConocoPhillips refers to the operator of the San Juan Basin Royalty Properties, other than the portion of such properties located in Colorado, and BP refers to the operator of the Colorado San Juan Basin Royalty Properties unless otherwise indicated.

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

- (a) the Trust cannot engage in any business or investment activity or purchase any assets;
- (b) the Royalty can be sold in part or in total for cash upon approval by the unitholders;
- (c) the Trustee can establish cash reserves and borrow funds to pay liabilities of the Trust and can pledge assets of the Trust to secure payment of the borrowings;
- (d) the Trustee will make cash distributions to the unitholders in January, April, July and October each year as discussed more fully in Note 2;

MESA ROYALTY TRUST

NOTES TO FINANCIAL STATEMENTS (Continued)

(Unaudited)

(e) the Trust will terminate upon the first to occur of the following events: (i) at such time as the Trust's royalty income for two successive years is less than \$250,000 per year or (ii) a vote by the unitholders in favor of termination. Upon termination of the Trust, the Trustee will sell for cash all the assets held in the Trust estate and make a final distribution to unitholders of any funds remaining after all Trust liabilities have been satisfied; and

(f) PNR, ConocoPhillips and BP (collectively the "Working Interest Owners") will reimburse the Trust for 59.34%, 27.45% and 1.77%, respectively, for general and administrative expenses of the Trust.

Note 2 Basis of Presentation

The accompanying unaudited financial information has been prepared by the Trustee in accordance with the instructions to Form 10-Q. The preparation of the financial statements requires estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates. The Trustee believes such information includes all the disclosures necessary to make the information presented not misleading. The information furnished reflects all adjustments which are, in the opinion of the Trustee, necessary for a fair presentation of the results for the interim periods presented. The financial information should be read in conjunction with the financial statements and notes thereto included in the Trust's Annual Report on Form 10-K for the year ended December 31, 2007.

In accordance with the instruments conveying the Royalty, the Working Interest Owners will calculate and pay the Trust each month an amount equal to 90% of the Net Proceeds (as defined in the Conveyance) attributable to the month. In 1985, the Trust Indenture was amended and the Trust conveyed to an affiliate of Mesa Petroleum Co. 88.5571% of the original Royalty (such transfer, the "1985 Assignment"). The effect of the 1985 Assignment was an overall reduction of approximately 88.56% in the size of the Trust. As a result, the Trust is now entitled to receive 11.44% of 90% of the Net Proceeds attributable to each month.

Amortization of the Royalty is computed on a unit-of-production basis and is charged directly to trust corpus since such amount does not affect distributable income.

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

(a) Royalty income recorded for a month is the amount computed and paid by the Working Interest Owners to the Trustee for such month rather than either the value of a portion of the oil and gas produced by the Working Interest Owners for such month or the amount subsequently determined to be the Trust's proportionate share of the net proceeds for such month;

(b) Interest income, interest receivable and distributions payable to unitholders include interest to be earned on short-term investments from the financial statement date through the next date of distribution;

(c) Trust general and administrative expenses, net of reimbursements, are recorded in the month they accrue; and

(d) Distributions payable are determined on a monthly basis and are payable to unitholders of record as of the last business day of each month or such other day as the Trustee determines is

MESA ROYALTY TRUST

NOTES TO FINANCIAL STATEMENTS (Continued)

(Unaudited)

required to comply with legal or stock exchange requirements. However, cash distributions are made quarterly in January, April, July and October, and include interest earned from the monthly record dates to the date of distribution.

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

Note 3 Legal Proceedings

There are no pending legal proceedings to which the Trust is a named party. PNR has advised the Trustee that the previously reached 2006 settlement in the lawsuit *John Steven Alford and Robert Larrabee, individually and on behalf of a Plaintiff Class v. Pioneer Natural Resources USA, Inc.*, filed in the 26th Judicial District Court, Stevens County, Kansas, was approved in the first quarter of 2007 by the Judge and the case was finalized in April 2007. The plaintiffs in the above noted lawsuit were royalty owners in oil and gas properties located in the Hugoton field, which are owned by PNR, a subsidiary of Pioneer. The plaintiffs sued a predecessor company to PNR asserting various claims relating to alleged improper deductions in the calculation of royalties.

Under the terms of the agreement, PNR agreed to make cash payments to settle the plaintiffs' claims with respect to production occurring on and before December 31, 2005. PNR also agreed to adjust the manner in which royalty payments to the class members will be calculated for production occurring on and after January 1, 2006.

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

Note 4 Federal Income Tax Matters

In a technical advice memorandum dated February 26, 1982, the IRS advised the Dallas District Director that the Trust is classifiable as a grantor trust and not as an association taxable as a corporation. As a grantor trust, the Trust will incur no federal income tax liability.

The Trustee assumes that some Trust Units are held by a middleman, as such term is broadly defined in U.S. Treasury Regulations (and includes custodians, nominees, certain joint owners, and brokers holding an interest for a custodian in street name). Therefore, the Trustee considers the Trust to be a non-mortgage widely held fixed investment trust ("WHFIT") for U.S. federal income tax purposes. Bank of New York Trust Company, N.A., 919 Congress Avenue, Austin, Texas 78701, telephone number 1-800-852-1422, is the representative of the Trust that will provide tax information in accordance with applicable U.S. Treasury Regulations governing the information reporting requirements of the Trust as a WHFIT.

MESA ROYALTY TRUST

NOTES TO FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 5 Recently Issued Pronouncements

In December 2008, the SEC announced that it had approved revisions designed to modernize the oil and gas company reserve reporting requirements. The most significant amendments to the requirements include the following:

commodity prices economic producibility of reserves and discounted cash flows will be based on a 12-month average commodity price unless contractual arrangements designate the price to be used;

disclosure of unproved reserves probable and possible reserves may be disclosed separately on a voluntary basis;

proved undeveloped reserve guidelines reserves may be classified as proved undeveloped if there is a high degree of confidence that the quantities will be recovered;

reserve estimation using new technologies reserves may be estimated through the use of reliable technology in addition to flow tests and production history; and

nontraditional resources the definition of oil and gas producing activities will expand and focus on the marketable product rather than the method of extraction.

The rules are effective for fiscal years ending on or after December 31, 2009, and early adoption is not permitted. The Trust is currently evaluating the new rules and assessing the impact they will have on its reported oil and gas reserves. The SEC is coordinating with the FASB to obtain the revisions necessary to SFAS No. 19, "Financial Accounting and Reporting by Oil and Gas Producing Companies," and SFAS No. 69, "Disclosures about Oil and Gas Producing Activities," to provide consistency with the new rules. In the event that consistency is not achieved in time for companies to comply with the new rules, the SEC will consider delaying the compliance date.

MESA ROYALTY TRUST

NOTES TO FINANCIAL STATEMENTS (Continued)

(Unaudited)

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

The following review of the Trust's financial condition and results of operations should be read in conjunction with the financial statements and notes thereto. The discussion of net production attributable to the Hugoton and San Juan properties represents production volumes that are to a large extent hypothetical as the Trust does not own and is not entitled to any specific production volumes. See Note 7 to the financial statements in the Trust's Annual Report on Form 10-K for the year ended December 31, 2007. Any discussion of "actual" production volumes represents the hydrocarbons that were produced from the properties in which the Trust has an overriding royalty interest.

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

Note Regarding Forward-Looking Statements

This Form 10-Q includes "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements other than statements of historical facts included in this Form 10-Q, including without limitation the statements under "Management's Discussion and Analysis of Financial Condition and Results of Operations," are forward-looking statements. Although the Working Interest Owners have advised the Trust that they believe that the expectations reflected in the forward-looking statements contained herein are reasonable, no assurance can be given that such expectations will prove 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 Annual Report on Form 10-K for the year ended December 31, 2007, including under "Item 1A. Risk Factors." All subsequent written and oral forward-looking statements attributable to the Trust or persons acting on its behalf are expressly qualified in their entirety by the Cautionary Statements.

SUMMARY OF ROYALTY INCOME, PRODUCTION AND AVERAGE PRICES

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

	Three Months Ended September 30,			
	2008 Natural Gas	2008 Oil, Condensate and Natural Gas Liquids	2007 Natural Gas	2007 Oil, Condensate and Natural Gas Liquids
The Trust's proportionate share of Gross Proceeds(1)	\$ 3,911,028	\$ 1,691,366	\$ 3,034,288	\$ 1,212,004
Less the Trust's proportionate share of:				
Capital costs recovered	(96,995)	(55,805)	(131,706)	(51,951)
Operating costs	(637,544)	(276,932)	(641,806)	(240,615)
Royalty income	\$ 3,176,489	\$ 1,358,629	\$ 2,260,776	\$ 919,438
Average sales price	\$ 9.11	\$ 65.76	\$ 5.95	\$ 42.54
	(Mcf)	(Bbls)	(Mcf)	(Bbls)
Net production volumes attributable to the Royalty(2)	348,675	20,662	377,403	21,658

	Nine Months Ended September 30,			
	2008 Natural Gas	2008 Oil, Condensate and Natural Gas Liquids	2007 Natural Gas	2007 Oil, Condensate and Natural Gas Liquids
The Trust's proportionate share of Gross Proceeds(1)	\$ 9,185,133	\$ 4,822,715	\$ 8,411,487	\$ 3,133,703
Less the Trust's proportionate share of:				
Capital costs recovered	(388,940)	(230,863)	(709,147)	(51,951)
Operating costs	(1,654,691)	(837,114)	(2,007,776)	(370,098)
Royalty income	\$ 7,141,502	\$ 3,754,738	\$ 5,694,564	\$ 2,711,654
Average sales price	\$ 7.41	\$ 60.75	\$ 5.84	\$ 38.09
	(Mcf)	(Bbls)	(Mcf)	(Bbls)
Net production volumes attributable to the Royalty(2)	956,096	61,958	970,988	71,823

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

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Three Months Ended September 30, 2008 and 2007

Financial Review

	Three Months Ended September 30,	
	2008	2007
Royalty income	\$ 4,535,119	\$ 3,180,214
Interest income	10,840	24,883
General and administrative expense	(35,801)	(18,062)
 Distributable income	 \$ 4,510,158	 \$ 3,187,035
 Distributable income per unit	 \$ 2.4201	 \$ 1.7102
 Units outstanding	 1,863,590	 1,863,590

The Trust's Royalty income was \$4,535,119 in the third quarter of 2008, an increase of approximately 43% as compared to \$3,180,214 in the third quarter of 2007, primarily as a result of increased prices for natural gas and natural gas liquids in the third quarter of 2008 as compared to the third quarter of 2007.

The distributable income of the Trust for each period includes the Royalty income received from the working interest owners during such period, plus interest income earned to the date of distribution. Trust administration expenses are deducted in the computation of distributable income. Distributable income for the quarter ended September 30, 2008 was \$4,510,158, representing \$2.4201 per unit, compared to \$3,187,035, representing \$1.7102 per unit, for the quarter ended September 30, 2007. Based on 1,863,590 units outstanding for the quarters ended September 30, 2008 and 2007, respectively, the per unit distributions were as follows:

	2008	2007
July	\$ 0.7699	\$ 0.6174
August	0.7889	0.5919
September	0.8613	0.5009
	 \$ 2.4201	 \$ 1.7102

Operational Review

Hugoton Field

Natural gas and natural gas liquids production attributable to the Royalty from the Hugoton field accounted for approximately 41% of the Royalty income of the Trust during the third quarter of 2008.

PNR has advised the Trust that since June 1, 1995 natural gas produced from the Hugoton field has generally been sold under short-term and multi-month contracts at market clearing prices to multiple purchasers recently including Greely Gas and Oneok 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. Overall market prices received for natural gas from the Hugoton Royalty Properties were higher in the third quarter of 2008 compared to the third quarter of 2007.

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In June 1994, PNR entered into a Gas Transportation Agreement ("Gas Transportation Agreement") with Western Resources, Inc. ("WRI") for a primary term of five years commencing June 1, 1995. This contract has renewed on a year-to-year basis since June 1, 2001. PNR extended the contract through June 1, 2010. Pursuant to the Gas Transportation Agreement, WRI agreed to compress and transport up to 160 MMcf per day of gas and redeliver such gas to PNR at the inlet of PNR's Satanta Plant. PNR agreed to pay WRI a fee of \$0.06 per Mcf escalating 4% annually as of June 1, 1996. This Gas Transportation Agreement was assigned to Kansas Gas Service ("Oneok").

Royalty income attributable to the Hugoton Royalty Properties increased to \$1,844,490 in the third quarter of 2008, as compared to \$1,237,354 in the third quarter of 2007 primarily due to an increase in overall prices received from the Hugoton Royalty Properties. The average price received in the third quarter of 2008 for natural gas and natural gas liquids sold from the Hugoton Royalty Properties was \$9.73 per Mcf and \$65.50 per barrel, respectively, compared to \$6.66 per Mcf and \$46.86 per barrel during the same period in 2007. Net production attributable to the Hugoton Royalty was 137,627 Mcf of natural gas and 7,723 barrels of natural gas liquids in the third quarter of 2008 compared to 135,835 Mcf of natural gas and 6,639 barrels of natural gas liquids in the third quarter of 2007. Actual production volumes attributable to the Hugoton properties decreased to 164,581 Mcf of natural gas and increased to 9,235 barrels of natural gas liquids in the third quarter of 2008 as compared to 188,313 Mcf of natural gas and 9,210 barrels of natural gas liquids for the same period in 2007 as a result of line repairs in the field.

Capital expenditures on these properties were \$0. In addition, the Trust received a credit of \$13,851 in the third quarter of 2008, as compared to \$36,117 in the third quarter of 2007. Operating costs were \$375,270 in the third quarter of 2008, a decrease of approximately 13% as compared to \$431,634 in the third quarter of 2007. The decrease in operating expenses between the three months ended September 30, 2007 and the three months ended September 30, 2008 is due to efforts to contain costs to offset vendor pricing increases.

San Juan Basin

Royalty income from the San Juan Basin Royalty Properties is calculated and paid to the Trust on a state-by-state basis. Substantially all of the Royalty income from the San Juan Basin Royalty Properties is attributable to the Royalty Properties located in the State of New Mexico. Royalty income from the San Juan Basin Royalty Properties located in the state of New Mexico was \$2,416,644 during the third quarter of 2008 as compared with \$1,586,626 in the third quarter of 2007. The increase was primarily due to higher natural gas and natural gas liquids prices offset in part by increased capital costs and operating expenses in the third quarter of 2008. The average price received in the third quarter of 2008 for natural gas sold from the San Juan Basin Royalty Properties was \$8.85 per Mcf and \$65.90 per barrel, respectively, compared to \$5.59 per Mcf and \$40.41 per barrel during the same period in 2007. Net production attributable to the San Juan Basin Royalty was 176,766 Mcf of natural gas and 12,939 barrels of natural gas liquids in the third quarter of 2008 as compared to 175,530 Mcf of natural gas and 15,019 barrels of natural gas liquids in the third quarter of 2007. Actual production volumes attributable to the San Juan Basin properties decreased to 224,779 Mcf of natural gas and 16,486 barrels of natural gas liquids in the third quarter of 2008 as compared to 249,146 Mcf of natural gas and 20,196 barrels of natural gas liquids for the same period in 2007. The decrease in actual production volume for the three month period ended September 30, 2008 compared to the same period in 2007 as a result of natural production fluctuations.

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San Juan-New Mexico capital expenditures were \$166,650 in the third quarter of 2008, an increase of 13% as compared to \$147,540 in the third quarter of 2007 due to increased drilling activity. Operating costs were \$491,761 in the third quarter of 2008, an increase of approximately 23% as compared to \$399,268 in the third quarter of 2007. The increase in operating expenses for the three month period ended September 30, 2008 compared to the same period in 2007 was due to increased repair and maintenance activity.

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

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

Royalty income from the San Juan Basin Colorado Royalty Properties was \$273,985 during the third quarter of 2008, compared to \$356,234 received during the third quarter of 2007. Royalty income received in the third quarter of 2007 from Red Willow operated properties relating to undistributed earnings from prior periods totaled \$206,836. Net production attributable to the San Juan Basin Royalty Properties located in Colorado was 34,283 Mcf of natural gas during the third quarter of 2008 compared to 66,038 Mcf of natural gas attributable to the Trust during the third quarter of 2007. The average price received in the third quarter of 2008 for natural gas sold from the San Juan Basin Colorado Properties was \$8.28. The average price received in the third quarter of 2007 for natural gas sold from the San Juan Basin Colorado Properties was \$5.39. Actual production volumes attributable to the San Juan Basin Colorado Properties decreased to 38,807 Mcf of natural gas in the third quarter of 2008 as compared to 75,652 Mcf of natural gas for the same period in 2007. Royalty income reported from BP is net of pre-main line production costs. These costs were charged to the Trust in error and as a result royalty income for previous periods was reduced. Because royalty income recorded for a month is the amount computed and paid by BP, the additional royalties, if any, will not be recorded until received.

Operating costs on these properties were \$47,445 in the third quarter of 2008, a decrease of approximately 8% as compared to \$51,519 in the third quarter of 2007 attributed to a decrease in maintenance work and lease operating expenses (labor, fuel, electricity, and chemicals).

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Nine Months Ended September 30, 2008 and 2007

Financial Review

	Nine Months Ended September 30,	
	2008	2007
Royalty income	\$ 10,896,240	\$ 8,406,218
Interest income	36,834	69,374
General and administrative expense	(96,075)	(64,904)
 Distributable income	 \$ 10,836,999	 \$ 8,410,688
 Distributable income per unit	 \$ 5.8151	 \$ 4.5132
 Units outstanding	 1,863,590	 1,863,590

The Trust's Royalty income was \$10,896,249 for the nine months ended September 30, 2008, an increase of approximately 30% as compared to \$8,406,218 for the nine months ended September 30, 2007, primarily as a result of higher natural gas and natural gas liquids prices in the first nine months of 2008 compared with the first nine months of 2007.

The distributable income of the Trust for each period includes the Royalty income received from the working interest owners during such period, plus interest income earned to the date of distribution. Trust administration expenses are deducted in the computation of distributable income. Distributable income for the nine months ended September 30, 2008 was \$10,837,008, representing \$5.8151 per unit, compared to \$8,410,688, representing \$4.5132 per unit, for the nine months ended September 30, 2007.

Operational Review

Hugoton Field

Natural gas and natural gas liquids revenue from the Hugoton field attributable to the Royalty accounted for approximately 41% of the Royalty income of the Trust during the nine months ended September 30, 2008.

Royalty income attributable to the Hugoton Royalty Properties increased to \$4,508,561 for the nine months ended September 30, 2008 from \$3,569,852 for the same period in 2007, due to increases in natural gas and natural gas liquids price from the Hugoton Royalty Properties slightly offset by decreases in natural gas and natural gas liquids production. The average price received in the first nine months of 2008 for natural gas and natural gas liquids sold from the Hugoton field was \$7.77 per Mcf and \$62.49 per barrel, compared to \$6.30 per Mcf and \$40.65 per barrel during the same period in 2007. Net production attributable to the Hugoton Royalty Properties decreased to 399,141 Mcf of natural gas and 22,193 barrels of natural gas liquids for the nine months ended September 30, 2008 as compared to 406,791 Mcf of natural gas and 24,701 barrels of natural gas liquids for the nine months ended September 30, 2007. Actual production volumes attributable to the Hugoton Royalty Properties decreased to 496,003 Mcf of natural gas and increased to 27,563 barrels of natural gas liquids for the nine months ended September 30, 2008 as compared to 565,612 Mcf of natural gas and 27,281 barrels of natural gas liquids for the same period in 2007. The decrease in gas production and the increase in the natural gas liquids production for the nine month period ended September 30, 2008 compared to the same period in 2007 was primarily due to the nitrogen rejection unit being down for a portion of

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

The Hugoton capital expenditures were \$2,949 during the nine months ended September 30, 2008, a decrease of approximately 94% as compared to \$51,995 during the nine months ended September 30, 2007. The decrease in the capital expenditures was primarily due to fewer capital workovers in 2008. Operating costs were \$1,064,250 during the nine months ended September 30, 2008, as compared to \$1,066,040 during the nine months ended September 30, 2007.

San Juan Basin

The San Juan-New Mexico Royalty income was \$5,739,675 for the first nine months of 2008 compared to \$4,098,811 in the first nine months of 2007. The increase in Royalty income was due primarily to higher prices for natural gas and natural gas liquids in the first nine months of 2008 from the San Juan Basin-New Mexico properties. Net production attributable to the San Juan-New Mexico properties increased to 455,299 Mcf of natural gas and decreased to 39,765 barrels of natural gas liquids for the nine months ended September 30, 2008 as compared to 420,338 Mcf of natural gas and 47,122 barrels of natural gas liquids for the nine months ended September 30, 2007. Actual production volumes attributable to the San Juan-New Mexico properties decreased to 624,450 Mcf of natural gas and 51,824 barrels of natural gas liquids in the nine months ended September 30, 2008 as compared to 716,324 Mcf of natural gas and 56,559 barrels of natural gas liquids for the same period in 2007. The decrease in production volume for natural gas and natural gas liquids for the nine month period ended September 30, 2008 compared to the same period 2007 was attributable to the slow recovery of the wells after they were shut down for maintenance and subsequently brought back online following a gas plant fire that occurred during the second quarter of 2008. The average price received in the nine months ended September 30, 2008 for natural gas and natural gas liquids sold from the San Juan-New Mexico properties was \$7.32 per Mcf and \$59.82 per barrel, respectively, compared to \$6.38 per Mcf and \$43.49 per barrel during the same period in 2007.

San Juan-New Mexico capital expenditures were \$616,854 during the nine months ended September 30, 2008, a decrease of approximately 15% as compared to \$709,103 during the nine months ended September 30, 2007. Operating costs were \$1,314,683 during the nine months ended September 30, 2008, an increase of approximately 7% as compared to \$1,226,650 during the nine months ended September 30, 2007 due to an increase in repair and maintenance activity.

Royalty income from the San Juan Basin Colorado Royalty Properties was \$648,004 for the nine months ended September 30, 2008, compared to \$737,555 received during the same period in 2007. Royalty income received in the nine months ended September 30, 2007 from Red Willow operated properties relating to undistributed earnings from prior periods totaled \$159,497. The operators did not pay to the Trust amounts received during the first nine months of 2006. Net production attributable to the San Juan Basin Royalty Properties located in Colorado was 98,829 Mcf of natural gas during the nine months ended September 30, 2008 with 143,859 Mcf of natural gas volumes attributable to the Trust during the same period in 2007. The average price received for the nine months ended September 30, 2008 for natural gas sold from the San Juan Basin Colorado Properties was \$6.53. The average price received for the nine months ended September 30, 2007 for natural gas sold from the San Juan Basin Colorado Properties was \$5.13. Actual production volumes attributable to the San Juan Basin Colorado Properties decreased to 116,605 Mcf of natural gas for the nine months ended September 30, 2008 as compared to 160,265 Mcf of natural gas for the same period in 2007 due to the

slow recovery of the wells after they were shut down for maintenance and subsequently brought back online following a gas plant fire that occurred during the second quarter of 2008.

Operating costs on these properties were \$112,870 for the nine months ended September 30, 2008, an increase of approximately 33% as compared to \$85,184 in the same period in 2007 were due to an increase in drilling and workover charges.

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

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

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

worldwide economic conditions;

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

the supply and price of foreign natural gas;

the level of consumer demand;

the price and availability of alternative fuels;

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

the effect of worldwide energy conservation measures.

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

Item 4. *Controls and Procedures.*

Evaluation of Disclosure Controls and Procedures. The Trustee maintains disclosure controls and procedures designed to ensure that information required to be disclosed by the Trust in the reports that it files or submits under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by the Trust in the reports that it files or submits under the Exchange Act is accumulated and communicated by the working interest owners to The Bank of New York Mellon Trust Company, N.A., as Trustee of the Trust, and its employees who participate in the preparation of the Trust's periodic reports as appropriate to allow timely decisions regarding required disclosure.

As of the end of the period covered by this report, the trust officer acting on behalf of the Trustee responsible for the administration of the Trust conducted an evaluation of the Trust's disclosure controls and procedures. The officer acting on behalf of the Trustee concluded that the Trust's controls and procedures were effective at that time.

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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, and reserve information, (iii) information relating to projected production, and (iv) conclusions regarding reserves by their internal reserve engineers or other experts in good faith. See Part I, Item 1A. "Risk Factors None of the Trustee or 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 Annual Report on Form 10-K for the year ended December 31, 2007 for a description of certain risks relating to these arrangements and reliance.

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

PART II OTHER INFORMATION

Item 1. Legal Proceedings.

There are no pending legal proceedings to which the Trust is a named party. PNR has advised the Trustee that the previously reached 2006 settlement in the lawsuit *John Steven Alford and Robert Larrabee, individually and on behalf of a Plaintiff Class v. Pioneer Natural Resources USA, Inc.*, filed in the 26th Judicial District Court, Stevens County, Kansas, was approved in the first quarter of 2007 by the Judge and the case was finalized in April 2007. The plaintiffs in the above noted lawsuit were royalty owners in oil and gas properties located in the Hugoton field, which are owned by PNR, a subsidiary of Pioneer. The plaintiffs sued a predecessor company to PNR asserting various claims relating to alleged improper deductions in the calculation of royalties.

Under the terms of the agreement, PNR agreed to make cash payments to settle the plaintiffs' claims with respect to production occurring on and before December 31, 2005. PNR also agreed to adjust the manner in which royalty payments to the class members will be calculated for production occurring on and after January 1, 2006.

Pioneer's portion of the cash payment was approximately \$32,700,000. Pioneer agreed to pay the cash portion in two installments. Pioneer advised the Trustee that the portion of the cash payments net to the Trust's interest was approximately \$1,000,000 paid on September 30, 2006 and an expected payment of \$986,138 payable on September 30, 2007. The approximate \$1,000,000 attributable to the Trust paid on September 30, 2006, was deducted from royalty income in the fourth quarter of 2006. In October 2007, Pioneer informed the Trustee that during the course of PNR's analysis of the payments under the terms of the settlement agreement, PNR has now determined that the Trust should not bear any portion of the second installment payment and that PNR should reimburse the Trust for the portion of the first installment payment previously charged to the Trust and paid in September 2006. As a result, PNR included a reimbursement of \$1,096,630, including interest in the amount of \$110,492, to the distribution made to the Trust in October 2007 which was included in the Trust's fourth quarter receipts, and no portion of the second installment payment was charged to the Trust.

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

Item 1A. Risk Factors.

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

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Item 6. Exhibits.

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

	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 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002		
32 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002		

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SUMMARY OF ROYALTY INCOME, PRODUCTION AND AVERAGE PRICES

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SIGNATURES