MESA ROYALTY TRUST/TX
Form 10-Q
August 12, 2016

QuickLinks -- Click here to rapidly navigate through this document

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period ended June 30, 2016

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

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

MESA ROYALTY TRUST

(Exact name of registrant as specified in its charter)

Texas (State or other jurisdiction of Incorporation or Organization)	**76-6284806** (I.R.S. Employer Identification No.)
The Bank of New York Mellon Trust Company, N.A., Trustee 601 Travis Street, Floor 16 Houston, Texas (Address of Principal Executive Offices)	**77002** (Zip Code)

1-713-483-6020
(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 ý No o

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

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 o	Accelerated filer o	Non-accelerated filer ý (Do not check if a smaller reporting company)	Smaller reporting company o

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 12, 2016 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 June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Royalty income	$ 182,988	$ 455,838	$ 387,633	$ 1,245,928
Interest income	450	25	707	25
General and administrative income (expense)	(38,303)	23,840	(86,983)	(141,091)
Distributable income	$ 145,135	$ 479,703	$ 301,357	$ 1,104,862
Distributable income per unit	$ 0.0779	$ 0.2574	$ 0.1617	$ 0.5929
Units outstanding	1,863,590	1,863,590	1,863,590	1,863,590

STATEMENTS OF ASSETS, LIABILITIES AND TRUST CORPUS

	June 30, 2016 (Unaudited)	December 31, 2015
ASSETS		
Cash and short-term investments	$ 1,145,135	$ 1,408,413
Net overriding royalty interest in oil and gas properties	42,498,034	42,498,034
Accumulated amortization	(39,850,755)	(39,763,316)
Total assets	$ 3,792,414	$ 4,143,131
LIABILITIES AND TRUST CORPUS		
Distributions payable	$ 145,846	$ 415,151
Trust corpus (1,863,590 units of beneficial interest authorized, issued and outstanding)	3,646,568	3,727,980
Total liabilities and trust corpus	$ 3,792,414	$ 4,143,131

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

MESA ROYALTY TRUST

STATEMENTS OF CHANGES IN TRUST CORPUS

(Unaudited)

	Three Months Ended June 30, 2016	Three Months Ended June 30, 2015	Six Months Ended June 30, 2016	Six Months Ended June 30, 2015
Trust corpus, beginning of period	$ 3,693,641	$ 3,805,922	$ 3,727,980	$ 4,013,833
Distributable income	145,135	479,703	301,357	1,104,862
Distributions to unitholders	(145,846)	(416,521)	(295,330)	(1,159,298)
Amortization of net overriding royalty interest	(46,362)	(64,445)	(87,439)	(154,738)
Trust corpus, end of period	$ 3,646,568	$ 3,804,659	$ 3,646,568	$ 3,804,659

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

MESA ROYALTY TRUST

NOTES TO FINANCIAL STATEMENTS

(Unaudited)

Note 1 Trust Organization and Provisions

The Mesa Royalty Trust (the "Trust") was created on November 1, 1979. On that date, Mesa Petroleum Co., predecessor to Mesa Limited Partnership ("MLP"), which was the predecessor to MESA Inc., conveyed to the Trust an overriding royalty interest (the "Royalty") equal to 90% of the Net Proceeds (as defined in the Conveyance and described below) attributable to the specified interests in properties conveyed by the assignor on that date (the "Subject Interests"). The Subject Interests consisted of interests in certain producing oil and gas properties located in the Hugoton field of Kansas, the San Juan Basin field of New Mexico and Colorado and the Yellow Creek field of Wyoming (the "Royalty Properties"). The Royalty is evidenced by counterparts of an Overriding Royalty Conveyance dated as of November 1, 1979 (the "Conveyance"). On April 30, 1991, MLP sold its interests in the Royalty Properties located in the San Juan Basin field to ConocoPhillips. ConocoPhillips sold the portion of its interests in the San Juan Basin Royalty Properties located in Colorado to MarkWest Energy Partners, Ltd. (effective January 1, 1993) and Red Willow Production Company (effective April 1, 1992). On October 26, 1994, MarkWest Energy Partners, Ltd. sold substantially all of its interest in the Colorado San Juan Basin Royalty Properties to BP Amoco Company ("BP"), a subsidiary of BP p.l.c. Until August 7, 1997, MESA Inc. operated the Hugoton Royalty Properties through Mesa Operating Co., a wholly owned subsidiary of MESA Inc. On August 7, 1997, MESA Inc. merged with and into Pioneer Natural Resources Company ("Pioneer"), formerly a wholly owned subsidiary of MESA Inc., and Parker & Parsley Petroleum Company merged with and into Pioneer Natural Resources USA, Inc. (successor to Mesa Operating Co.), a wholly owned subsidiary of Pioneer ("PNR") (collectively, the mergers are referred to herein as the "Merger"). Subsequent to the Merger, the Hugoton Royalty Properties were operated by PNR until December 31, 2014, at which point Linn Energy Holdings, LLC ("Linn") took over as operator. Substantially all of the San Juan Basin Royalty Properties located in New Mexico are operated by ConocoPhillips. Effective January 1, 2005, ConocoPhillips assigned its interest in an immaterial number of San Juan Basin Royalty Properties located in New Mexico to XTO Energy Inc. The San Juan Basin Royalty Properties located in Colorado are operated by BP. As used in this report, Linn refers to the current operator of the Hugoton Royalty Properties, ConocoPhillips refers to the operator of the San Juan Basin Royalty Properties, other than the portion of such properties located in Colorado, and BP refers to the operator of the Colorado San Juan Basin Royalty Properties unless otherwise indicated.

Effective October 2, 2006, The Bank of New York Mellon Trust Company, N.A. (the "Trustee") succeeded JP Morgan 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 (as amended, 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;

MESA ROYALTY TRUST

NOTES TO FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 1 Trust Organization and Provisions (Continued)

(c) the Trustee can establish cash reserves and borrow funds to pay liabilities of the Trust and can pledge assets of the Trust to secure payment of the borrowings;

(d) the Trustee will make cash distributions to the unitholders in January, April, July and October each year as discussed more fully in Note 2;

(e) the Trust will terminate upon the first to occur of the following events: (i) at such time as the Trust's royalty income for two successive years is less than $250,000 per year or (ii) a vote by 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) Linn, 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.

As of June 30, 2016, there were $812 of unreimbursed expenses. The Trust anticipated receipt of these expense reimbursements by month-end when it published its June distribution press release on June 16, 2016, and included these amounts in distributions payable and distributable income per unit as of June 30, 2016. During 2011, the Trustee withheld $1.0 million for future unknown contingent liabilities and expenses in accordance with the Trust Indenture. At any given time, the amount currently reserved for such future unknown contingent liabilities and expenses is included in cash and short term investments. For the three months ended June 30, 2016, the Trustee decreased the reserve for future unknown contingent liabilities and expenses by the amount of expected expense reimbursement cash receipts of $812 and increased the reserve for future unknown contingent liabilities and expenses for a prior period expense refund received from a vendor in the amount of $101. For the six months ended June 30, 2016, the Trustee increased the reserve for future unknown contingent liabilities and expenses by (i) the amounts received during the first quarter of 2016 related to expense reimbursement cash receipts for previous periods totaling $6,738 and (ii) a prior period expense refund received from a vendor in the amount of $101 during the second quarter of 2016. The Trustee decreased the reserve for future unknown contingent liabilities and expenses by the amount of expected expense reimbursement cash receipts of $812. As of June 30, 2016, the reserve for unknown contingent liabilities and expenses was $999,289 and is included in cash and short term investments. The Trust has subsequently received $812 of the expected expense reimbursement cash receipts as of July 5, 2016, which has increased the reserve for unknown contingent liabilities and expenses. The Trustee reserves the right to determine whether or not to release cash reserves in future periods with respect to any unreimbursed expenses.

The Trustee was due $118,750 for its services for the quarter ended June 30, 2016. The Trust paid $108,288 of this amount to the Trustee, and $10,462 was allocated to offset against interest due to the Trust under the Trust Indenture. The Trust Indenture requires that cash being held by the Trustee earn interest at 1.5% below the prime rate, which would have yielded the Trust a 2.0% return as of June 30,

MESA ROYALTY TRUST

NOTES TO FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 1 Trust Organization and Provisions (Continued)

2016. However, due to the current interest rate environment, the Trustee was unable to obtain an account in which such an interest rate was available. In the event such an interest rate is unavailable in the future, the Trustee intends to allocate certain of its fees due to the Trust to meet the minimum interest rate payable under the Trust Indenture. The Trustee will continue to allocate a portion of the fees earned for its services to the Trust until the remaining $38,191 of interest due to the Trust is fully offset, and it may do so in future periods in which unpaid interest is due to the Trust. The Working Interest Owners partially reimburse the Trust each quarter for amounts paid in connection with the Trustee's services. For the quarter ended June 30, 2016, the Trustee's fees were $118,750 and such reimbursements totaled $95,897. For year to date June 30, 2016, the Trustee's fees were $216,576 and such reimbursements totaled $191,794. For the quarter ended June 30, 2015 and the six months ended June 30, 2015, the Trustee's fees were $108,388 and $216,676, respectively. Reimbursements received for the quarter ended June 30, 2015 and the six months ended June 30, 2015 were $95,988 and $191,888, respectively.

On May 11, 2016, Linn Energy, LLC ("Linn Energy"), Linn's parent company, announced that Linn Energy, LinnCo, LLC ("LinnCo") and Berry Petroleum Company, LLC ("Berry" and together with Linn Energy and LinnCo, the "Linn Parties") entered into a Restructuring Support Agreement with holders of at least 66.67% by aggregate outstanding principal amounts of Linn Energy's Amended and Restated Credit Agreement, dated as of April 24, 2013, as amended, and Berry's Second Amended and Restated Credit Agreement, dated as of November 15, 2010, as amended. In order to implement the terms of the Restructuring Support Agreement, Linn Energy announced that the Linn Parties filed voluntary petitions for restructuring under Chapter 11 of the Bankruptcy Code ("Chapter 11") in the United States Bankruptcy Court for the Southern District of Texas. In light of the pending Chapter 11 cases, the extent of the impact, if any, on the Trust is currently unclear. However, the Linn Parties' Chapter 11 process may result in reduced production of reserves and decreased distributions to unitholders. For more information on the potential impact of the Linn Parties' bankruptcy filing on the Trust's financial condition and results of operations, see Part II Item 1A "Risk Factors The financial condition of operators of the underlying properties could impede the operation of wells" in this Form 10-Q.

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

MESA ROYALTY TRUST

NOTES TO FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 2 Basis of Presentation (Continued)

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, 2015. The Trust considers all highly liquid investments with a maturity of three months or less to be cash equivalents. Subsequent events were evaluated through the issuance date of the financial statements.

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

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

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

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

(c) Trust general and administrative expenses, net of reimbursements, are recorded in the month they are included in the calculation of the monthly distribution amount;

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

(e) Distributions payable are determined on a monthly basis and are payable to unitholders of record as of the last business day of each month or such later date as the Trustee determines is required to comply with applicable law or stock exchange requirements. However, cash distributions are made quarterly in January, April, July and October, and include interest earned from the monthly record dates to the date of distribution.

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

MESA ROYALTY TRUST

NOTES TO FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 3 Legal Proceedings

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

Note 4 Income Tax Matters

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

For taxable years beginning after December 31, 2012, individuals, estates, and trusts with income above certain thresholds are subject under Section 1411 of the Internal Revenue Code to an additional 3.8% tax also known as the "Medicare contribution tax" on their net investment income. Grantor trusts such as Mesa Royalty Trust are not subject to the 3.8% tax; however, the unitholders may be subject to the tax. For these purposes, investment income would generally include certain income derived from investments, such as the royalty income derived from the units and gain realized by a unitholder from a sale of units.

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. The Bank of New York Mellon Trust Company, N.A., 601 Travis Street, Floor 16, Houston, Texas 77002, telephone number 713-483-6020, is the representative of the Trust that will provide tax information in accordance with applicable U.S. Treasury Regulations governing the information reporting requirements of the Trust as a WHFIT.

Notwithstanding the foregoing, the middlemen holding units on behalf of unitholders, and not the Trustee of the Trust, are solely responsible for complying with the information reporting requirements under the Treasury Regulations with respect to such units, including the issuance of IRS Forms 1099 and certain written tax statements. Unitholders whose units are held by middlemen should consult with such middlemen regarding the information that will be reported to them by the middlemen with respect to the units.

MESA ROYALTY TRUST

NOTES TO FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 5 Excess Production Costs

Excess production costs result when costs, charges, and expenses attributable to a working interest property exceed the revenue received from the sale of oil, gas, and other hydrocarbons produced from such property for the period reported. The excess production costs must be recovered by the working interest owners before any distribution of Royalty income from the properties will be made to the Trust. As of June 30, 2016 and December 31, 2015, there were $11,542 and $78,591, respectively, of excess production costs. Excess production costs in the amount of $2,093 and $1,107 as of June 30, 2016 and December 31, 2015, respectively, related to the San Juan Basin New Mexico properties operated by XTO Energy Inc. XTO Energy Inc. made distributions to the Trust during the first and second quarters of 2015 without recovering the $478 excess production costs. The remainder of the excess production costs in the amount of $9,449 as of June 30, 2016 and $77,484 as of December 31, 2015, related to the San Juan Basin Colorado properties operated by BP and Red Willow. Excess production costs related to the San Juan Basin Colorado properties operated by BP were approximately $0 and $72,336 as of June 30, 2016 and December 31, 2015, respectively. Excess production costs related to the San Juan Basin Colorado properties operated by Red Willow were approximately $9,449 and $5,148 as of June 30, 2016 and December 31, 2015, respectively.

Note 6 Distributable Income Per Unit

During 2011, the Trustee withheld $1.0 million for future unknown contingent liabilities and expenses in accordance with the Trust Indenture. For the three months ended June 30, 2016, the Trustee decreased the reserve for future unknown contingent liabilities and expenses by the amount of expected expense reimbursement cash receipts of $812 and increased the reserve for future unknown contingent liabilities and expenses for a prior period expense refund received from a vendor in the amount of $101. For the six months ended June 30, 2016, the Trustee increased the reserve for future unknown contingent liabilities and expenses by the amounts received during the first quarter of 2016 related to expense reimbursement cash receipts for previous periods totaling $6,738 and a prior period expense refund received from a vendor in the amount of $101 during the second quarter of 2016. The Trustee decreased the reserve for future unknown contingent liabilities and expenses by the amount of

MESA ROYALTY TRUST

NOTES TO FINANCIAL STATEMENTS (Continued)

(Unaudited)

Note 6 Distributable Income Per Unit (Continued)

expected expense reimbursement cash receipts of $812. The effect on distributable income per unit is as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	**2015**	**2016**	**2015**
Distributable Income Before Reserve for Contingent Liabilities and Expenses	$ 145,135	$ 479,703	$ 301,357	$ 1,104,862
Increase in Reserve for Contingent Liabilities and Expenses (See Note 1)	(101)	(115,885)	(6,839)	
Withdrawal from Reserve for Contingent Liabilities and Expenses (See Note 1)	812	52,703	812	54,436
Distributable income Available for Distribution	$ 145,846	$ 416,521	$ 295,330	$ 1,159,298