MESA ROYALTY TRUST/TX
Form 10-K
April 02, 2018

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2017

Or

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	**76-6284806**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

The Bank of New York Mellon Trust Company, N.A., Trustee
Global Corporate Trust
601 Travis Street, Floor 16

Houston, Texas	**77002**
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: **713-483-6020**

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange On Which Registered
Units of Beneficial Interest	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No ý

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No ý

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 Website, 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ý

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) if the Exchange Act. o

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

The aggregate market value of 1,863,590 Units of Beneficial Interest in Mesa Royalty Trust held by non-affiliates of the registrant at the closing sales price on June 30, 2017 of $11.70 was approximately $21,804,003.

As of April 2, 2018, 1,863,590 Units of Beneficial Interest were outstanding in Mesa Royalty Trust.

DOCUMENTS INCORPORATED BY REFERENCE: None

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DISCLOSURES REGARDING FORWARD-LOOKING STATEMENTS

This Form 10-K includes "forward-looking statements" about Mesa Royalty Trust (the "Trust") and other matters discussed herein that are subject to risks and uncertainties that are intended to qualify for the safe harbor from liability established by the Private Securities Litigation Reform Act of 1995 and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). All statements other than statements of historical fact included in this document, including, without limitation, statements under "Management's Discussion and Analysis of Financial Condition and Results of Operations," including the Trust's or any Working Interest Owner's (as defined in "*Item 1 Description of the Trust*") future financial position, status in any insolvency proceeding, business strategy, budgets, projected costs and plans and objectives for future operations, information regarding target distributions, statements pertaining to future development activities and costs, statements regarding the number of development wells to be completed in future periods, and information regarding production and reserve growth, are forward-looking statements. Actual outcomes and results may differ materially from those projected. Forward-looking statements are generally accompanied by words such as "estimate," "project," "predict," "believe," "expect," "anticipate," "potential," "could," "may," "can," "foresee," "plan," "goal," "assume," "target," "should," "intend" or other words that convey the uncertainty of future events or outcomes. These statements are based on certain assumptions made by the Trust in light of its experience and perception of historical trends, current conditions and expected

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future developments, as well as other factors we believe are appropriate under the circumstances. The Trustee relies on the Working Interest Owners for information regarding the Subject Interests (as defined in "Description of the Trust" under Item 1), the Royalty (as defined in "Description of the Trust" under Item 1), and the Working Interest Owners themselves.

Although the Working Interest Owners have advised the Trust that they believe that the expectations reflected in the forward-looking statements contained herein are reasonable, no assurance can be given that such expectations will prove to be correct. However, whether actual results and developments will conform with such expectations and predictions is subject to a number of risks and uncertainties, including the risk factors discussed in this Form 10-K, and those set forth from time to time in the Trust's filings with the Securities and Exchange Commission (the "SEC"), which could affect the future results of the energy industry in general, and the Trust and the Working Interest Owners in particular, and could cause those results to differ materially from those expressed in such forward-looking statements. The actual results or developments anticipated may not be realized or, even if substantially realized, they may not have the expected consequences to or effects on the Working Interest Owners' businesses and the Trust. Such statements are not guarantees of future performance and actual results or developments may differ materially from those projected in such forward-looking statements. The Trust undertakes no obligation to publicly update or revise any forward-looking statements, except as required by applicable law.

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PART I

Item 1. Business.

DESCRIPTION OF THE TRUST

The Trust, created under the laws of the State of Texas, maintains its offices at the office of the Trustee, The Bank of New York Mellon Trust Company, N.A., (the "Trustee"), 601 Travis Street, Floor 16, Houston, Texas 77002. The telephone number of the Trust is 713-483-6020. The Bank of New York Mellon Trust Company, N.A., is the successor Trustee from JPMorgan Chase Bank, N.A., which is the successor by mergers to the originally named Trustee, Texas Commerce Bank National Association. The Trust has no employees. Administrative functions of the Trust are performed by the Trustee. The Trustee maintains a website for the Trust that makes available, free of charge, filings by the Trust with the Securities and Exchange Commission ("SEC") and other information. Any reports filed with the SEC are accessible free of charge through our website as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. The Trust's website is http://mtr.investorhq.businesswire.com/.

Trust Corpus Description. The Mesa Royalty Trust (the "Trust") was created on November 1, 1979, and is now governed by the Mesa Royalty Trust Indenture (as amended, the "Trust Indenture"). Through a series of conveyances, assignments, and acquisitions, the Trust currently owns an overriding royalty interest (the "Royalty") equal to 11.44% of 90% of the Net Proceeds (as defined in the Conveyance and described below) attributable to the specified interest in certain producing oil and gas properties located in the:

Hugoton field of Kansas (the "Hugoton Royalty Properties");

San Juan Basin field of New Mexico (the "San Juan Basin New Mexico Properties"); and

San Juan Basin field of Colorado (the "San Juan Basin Colorado Properties", and together with the "San Juan Basin New Mexico Properties, the "San Juan Basin Royalty Properties", and together with the Hugoton Royalty Properties and the San Juan Basin Royalty Properties, the "Royalty Properties").

Trust Corpus Conveyance History. On November 1, 1979, Mesa Petroleum Co., predecessor to Mesa Limited Partnership ("MLP"), which was the predecessor to MESA Inc., conveyed to the Trust 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 the Royalty Properties described above. The Royalty is evidenced by counterparts of an Overriding Royalty Conveyance, dated as of November 1, 1979 (the "Conveyance"). 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.

Hugoton Royalty Properties. 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, a subsidiary of Linn Energy, LLC ("Old Linn") took over as operator. Pursuant to the bankruptcy proceedings and court-approved plans of reorganization involving

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Old Linn, which are described in detail below, Linn Energy, Inc. (together with its subsidiaries, "Linn") became the operator of the Hugoton Royalty Properties on February 28, 2017. Linn currently operates the Hugoton Royalty Properties.

San Juan Basin Colorado Properties. On April 30, 1991, MLP sold to Conoco, Inc. ("ConocoPhillips") its interests in the San Juan Basin Royalty Properties (the "San Juan Basin Sale"). The Trust's interest in the San Juan Basin Royalty Properties was conveyed from PNR's working interest in 31,328 net producing acres in northwestern New Mexico and southwestern Colorado. ConocoPhillips sold the portion of its interests in the San Juan Basin Colorado Properties to MarkWest Energy Partners, Ltd. (effective January 1, 1993) and Red Willow Production Company ("Red Willow") (effective April 1, 1992). On October 26, 1994, MarkWest Energy Partners, Ltd. sold substantially all of its interest in the San Juan Basin Colorado Properties to BP Amoco Company ("BP"), a subsidiary of BP p.l.c. BP and Red Willow currently operate the San Juan Basin Colorado Properties.

San Juan Basin New Mexico Properties. Starting from the date of the San Juan Basin Sale and ending on July 31, 2017, ConocoPhillips operated substantially all of the San Juan Basin New Mexico Properties, except an immaterial number of properties assigned to XTO Energy, Inc. ("XTO") effective January 1, 2005. On July 31, 2017, ConocoPhillips sold its San Juan Basin assets to Hilcorp San Juan LP ("Hilcorp"), an affiliate of Hilcorp Energy Company. Hilcorp currently operates the San Juan Basin New Mexico Properties. Effective September 2017, following Hilcorp's acquisition of Conoco's interests in the San Juan New Mexico Properties, Hilcorp continued to make an estimated payment of Net Proceeds to the Trust each month consistent with the monthly amount previously paid by ConocoPhillips. These estimated payments remain subject to reconciliation with respect to actual revenue, costs and net proceeds and the effects of pricing during the months after Hilcorp has completed its transition as owner of the San Juan New Mexico Properties. The reconciliation and true-up of the estimated payments for this transition period may affect the Trust's future receipt of Net Proceeds from Hilcorp.

As used in this report, Linn refers to the current operator of the Hugoton Royalty Properties, Hilcorp refers to the current operator of the San Juan Basin New Mexico Properties, and BP and Red Willow refers to the current co-operators of certain tracts of land included in the San Juan Basin Colorado Properties, unless otherwise indicated. The Royalty Properties are required to be operated by the Working Interest Owners (as defined below) in accordance with reasonable and prudent business judgment and good oil and gas field practices. Each Working Interest Owner has the right to abandon any well or lease if, in its opinion, such well or lease ceases to produce or is not capable of producing oil, gas or other minerals in commercial quantities. Each Working Interest Owner markets the production on terms deemed by it to be the best reasonably obtainable in the circumstances. See "Contracts". The Trustee has no power or authority to exercise any control over the operation of the Royalty Properties or the marketing of production therefrom.

Trustee and Terms of Trust Indenture. Effective October 2, 2006, the Trustee succeeded JPMorgan Chase Bank, N.A. as Trustee of the Trust. The Trust is a passive entity whose purposes are limited to: (1) converting the Royalty to cash, either by retaining it and collecting the proceeds of production (until production has ceased or the Royalty is otherwise terminated) or by selling or otherwise disposing of the Royalty 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 Royalty and interest on cash held by the Trustee as a reserve for liabilities or for distribution. The terms of 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;

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(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 of the Notes to Financial Statements contained in Item 8 of this Form 10-K;

(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, Hilcorp and BP (each, a "Working Interest Owner", and 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.

Linn Energy, LLC Reorganization. On May 11, 2016, Old Linn, LinnCo, LLC ("LinnCo"), an affiliate of Old Linn, and certain of Old Linn's direct and indirect subsidiaries (collectively with Old Linn and LinnCo, the "Debtors"), filed voluntary petitions for reorganization under Chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the Southern District of Texas (the "Court"). The Debtors' Chapter 11 cases were administered jointly under the caption *In re Linn Energy, LLC, et al.*, Case No. 16 60040.

On January 27, 2017, the Court entered the *Order Confirming (I) Amended Joint Chapter 11 Plan of Reorganization of Linn Energy, LLC and its Debtor Affiliates Other Than Linn Acquisition Company, LLC and Berry Petroleum Company, LLC and (II) Amended Joint Chapter 11 Plan of Reorganization of Linn Acquisition Company, LLC and Berry Petroleum Company, LLC,* which approved and confirmed the Amended Joint Chapter 11 Plan of Reorganization of Linn Energy, LLC and Its Debtor Affiliates Other Than Linn Acquisition Company, LLC and Berry Petroleum Company, LLC (the "Plan"). The Plan became effective on February 28, 2017 (the "Effective Date").

Pursuant to the Plan, on the Effective Date, all assets of Old Linn (other than equity interests in Linn Acquisition Company, LLC and Berry Petroleum Company, LLC) were conveyed to Linn, and LinnCo, LLC and Linn Energy, LLC were wound down and liquidated. Subsequent to the effectiveness of the Plan, Linn Energy, Inc. is now the reorganized successor to Old Linn. Under the Plan Supplement, as amended, filed with the Court, the Debtors assumed all executory contracts and unexpired leases with the Trust and Mesa Operating Limited Partnership as the counterparty. Furthermore, pursuant to the Plan, the royalty interests in the Hugoton Royalty Properties owned by the Trust shall be preserved and remain in full force and effect in accordance with the terms of the granting instruments or other governing documents.

Discussion of Net Proceeds. The Conveyance provides for a monthly computation of Net Proceeds. Net Proceeds is defined in the Conveyance as the "Gross Proceeds" received by the Working Interest Owners during a particular period, minus certain production and capital costs for such period. "Gross Proceeds" is defined in the Conveyance as the amount received by the Working Interest Owners from the sale of "Subject Minerals", subject to certain adjustments. "Subject Minerals" means all oil, gas and other minerals, whether similar or dissimilar, in and under, and which may be produced, saved and sold from, and which accrue and are attributable to, the Subject Interests from and after November 1, 1979. "Production costs" means, generally, costs incurred on an accrual basis by the Working Interest Owners in operating the Royalty Properties, including capital and non-capital costs. If production and capital costs exceed Gross Proceeds for any month, the excess, plus interest thereon at 120% of the prime rate of Bank of America, is recovered out of future Gross Proceeds prior to the making of further payment to the Trust. The Trust, however, is generally not liable for any operating costs or other costs or

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liabilities attributable to the Royalty Properties or minerals produced therefrom. The Trust is not obligated to return any Royalty income received in any period.

The Working Interest Owners are required to maintain books and records sufficient to determine the amounts payable under the Royalty. Additionally, in the event of a controversy between a Working Interest Owner and any purchaser as to the correct sales price for any production, amounts received by such Working Interest Owner and promptly deposited by it with an escrow agent are not considered to have been received by such Working Interest Owner, and, therefore, are not subject to being payable with respect to the Royalty until the controversy is resolved; but all amounts thereafter paid to such Working Interest Owner by the escrow agent will be considered amounts received from the sale of production. Similarly, operating costs include any amounts a Working Interest Owner is required to pay whether as a refund, interest or penalty to any purchaser because the amount initially received by such Working Interest Owner as the sales price was in excess of that permitted by the terms of any applicable contract, statute, regulation, order, decree or other obligation. Within 30 days following the close of each calendar quarter, the Working Interest Owners are required to deliver to the Trustee a statement of the computation of Net Proceeds attributable to such quarter.

The brief discussions of the Trust Indenture and the Conveyance contained herein are qualified in their entirety by reference to the Trust Indenture and the Conveyance themselves, which are exhibits to this Form 10-K and are available upon request from the Trustee.

DESCRIPTION OF THE UNITS

Each unit of beneficial interest is evidenced by a transferable certificate issued by the Trustee. Each unit ranks equally for purposes of distributions and has one vote on any matter submitted to unitholders. A total of 1,863,590 units were outstanding at April 2, 2018.

Distributions

The Trustee determines for each month the amount of cash available for distribution to unitholders for such month (the "Monthly Distribution Amount"), which consists of the cash received from the Royalty during such month, minus the obligations of the Trust paid during such month as adjusted for changes during such month in any cash reserves established for the payment of contingent or future obligations of the Trust made by the Trustee. The Monthly Distribution Amount for each month is payable to unitholders of record on the monthly record date, which is the close of business on the last business day of such month or such other date as the Trustee determines is required to comply with legal or stock exchange requirements. However, pursuant to the Trust Indenture and in order to reduce the administrative expenses of the Trust, the Trustee does not distribute cash monthly. Instead, the Trustee makes distributions during January, April, July and October of each year. While distributions are only made four times per calendar year, the Trustee distributes to each person who was a unitholder of record on one or more of the immediately preceding three monthly record dates, an amount equal to the Monthly Distribution Amount for the month or months that such holder was a unitholder of record plus interest earned on such Monthly Distribution Amount from the Monthly Record Date to the payment date. Under the terms of the Trust Indenture, interest is earned at a rate of 1.5% below the greater of (i) the prime rate charged by The Bank of New York Mellon Trust Company, N.A. or (ii) the interest rate which The Bank of New York Mellon Trust Company, N.A. pays in the normal course of business on amounts placed with it. Interest income may vary significantly across different payment dates.

The Working Interest Owners reimburse the Trust for portions of the total expenses incurred each month. The portions of expenses incurred by the Trustee without reimbursement from the Working Interest Owners are unreimbursed expenses. Unreimbursed expenses for any reporting period and are

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included in general and administrative expenses, which results in a reduction of distributable income. As of December 31, 2017, there were $0 unreimbursed expenses.

The terms of the Trust Indenture provide, among other things, that the Trustee may establish cash reserves and borrow funds to pay liabilities of the Trust and may pledge assets of the Trust to secure payment of the borrowings. 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 (the "Contingent Reserve") is included in cash and short-term investments.

For the year ended December 31, 2017, the Trustee increased the Contingent Reserve by (i) $82,244 of Royalty income received from BP in March 2017 after the distribution to unitholders had been announced for the month of March 2017, which Royalty income was included in the April 2017 distribution to unitholders, (ii) $47,840 of Royalty income received from BP in June 2017 after the distribution to unitholders had been announced for the month of June 2017, which Royalty income was included in the July 2017 distribution to unitholders, (iii) $1,307 for the amount of September expected expense reimbursement cash receipts, received in October 2017, (iv) $49,211 of Royalty income received from BP in December 2017 after the distribution to unitholders had been announced for the month of December 2017, which Royalty income was included in the January 2018 distribution to unitholders, and (v) $70,460 of December 2017 expenses that were included in the distribution calculation for December 2017, but not paid by the Trust until January 2018. For the year ended December 31, 2017, the Trustee decreased the Contingent Reserve by (i) $82,244 and $47,840 of aggregate Royalty income received from BP in March 2017 and June 2017, respectively, and (ii) $1,307 for expected expense reimbursement cash receipts. The net effects of the foregoing adjustments for the year ended December 31, 2017 resulted in the balance of the Contingent Reserve being equal to $1,119,671 as of December 31, 2017.

For the year ended December 31, 2016, the Trustee increased the Contingent Reserve by (i) $6,738 and $812 for expense reimbursement cash receipts for the first and third quarters of 2016, respectively, (ii) $101 for a prior period expense refund received from a vendor, and (iii) $107,659 for Royalty income received from BP in September 2016 after the distribution to unitholders had been announced for the month of September 2016, which Royalty income was included in the October 2016 distribution to unitholders. For the year ended December 31, 2016, the Trustee decreased the Contingent Reserve by (i) $101 for prior period expense refund received from a vendor, (ii) $812 for expected expense reimbursement cash receipts, and (iii) $107,659 for Royalty income received from BP in September 2016 after the distribution to unitholders had been announced for the month of September 2016, which Royalty income was included in the October 2016 distribution to unitholders. The net effects of the foregoing adjustments for the year ended December 31, 2016 resulted in the balance of the Contingent Reserve being equal to $1,000,000 as of December 31, 2016.

Liability of Unitholders

In regard to the unitholders, the Trustee is fully liable if the Trustee incurs any liability without ensuring that such liability will be satisfiable only out of the Trust's assets (regardless of whether the assets are adequate to satisfy the liability) and in no event out of amounts distributed to, or other assets owned by, the unitholders. However, under Texas law, it is unclear whether a unitholder would be jointly and severally liable for any liability of the Trust in the event that all of the following conditions were to occur: (1) the satisfaction of such liability was not by contract limited to the assets of the Trust, (2) the assets of the Trust were insufficient to discharge such liability, and (3) the assets of the Trustee were insufficient to discharge such liability. Although each unitholder should weigh this potential exposure in deciding whether to retain or transfer his units, the Trustee is of the opinion that because of the passive nature of the Trust assets, the restrictions on the power of the Trustee to incur

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liabilities, and the required financial net worth of any trustee, the imposition of any liability on a unitholder is extremely unlikely.

Federal Income Tax Matters

This section is a summary of federal income tax matters of general application, which addresses the material tax consequences of the ownership and sale of the Trust's units. Except where indicated, the discussion below describes general federal income tax considerations applicable to individuals who are citizens or residents of the U.S. Accordingly, the following discussion has limited application to domestic corporations and persons subject to specialized federal income tax treatment, such as regulated investment companies and insurance companies. It is impractical to comment on all aspects of federal, state, local and foreign laws that may affect the tax consequences of the transactions contemplated hereby and of an investment in the units as they relate to the particular circumstances of every unitholder. **Each unitholder should consult its own tax advisor with respect to its particular circumstances.**

Classification of the Trust

In a technical advice memorandum dated February 26, 1982, the National Office of the Internal Revenue Services (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 such unitholder's pro rata share of the income and expense of the Trust as if such unitholder were the direct owner of a pro rata share of the Trust's assets. In addition, there is no state tax liability for the period.

The Trustee assumes that some Trust units are held by 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.

The U.S. Tax Cuts and Job Act (the "2017 Tax Act") was enacted on December 22, 2017. The 2017 Tax Act is comprehensive legislation that contains substantial changes to U.S. taxation. The Trust does not expect the new tax law to have any significant impact due to the Trust being classified as a grantor trust for U.S. income tax purposes. However, unitholders should consult with their personal tax advisors to determine how the 2017 Tax Act impacts any items of income or deduction received from the Trust.

This summary is based on current provisions of the Internal Revenue Code of 1986, as amended ("Code"), existing and proposed Internal Revenue Treasury Regulations ("Treasury Regulations") thereunder and current administrative rulings and court decisions, all of which are subject to changes that may or may not be retroactively applied. In addition, the Code and Treasury Regulations are expected to be changed based on the enactment of the 2017 Tax Act. The 2017 Tax Act has not been interpreted by the courts or the IRS. No assurance can be provided that the statements set forth herein

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(which do not bind the IRS or any court) will not be challenged by the IRS or will be sustained by any court if challenged.

Income and Depletion

Royalty income, net of depletion and severance taxes, is portfolio income. Subject to certain exceptions and transitional rules, royalty income cannot be offset by passive losses. Additionally, interest income is portfolio income. Administrative expense is an investment expense.

Generally, prior to the Revenue Reconciliation Act of 1990, the transferee of an oil and gas property could not claim percentage depletion with respect to production from the property if it was "proved" at the time of the transfer. This rule is not applicable in the case of transfers of properties after October 11, 1990. Thus, eligible unitholders who acquired units after that date are entitled to claim an allowance for percentage depletion with respect to Royalty income attributable to such units to the extent that this allowance exceeds cost depletion as computed for the applicable period.

Backup Withholding

Distributions from the Trust are generally subject to backup withholding at a rate of 28%. Backup withholding will not normally apply to distributions to a unitholder unless the unitholder fails to properly provide to the Trust his taxpayer identification number or the IRS notifies the Trust that the taxpayer identification number provided by the unitholder is incorrect.

Sale of Units

Generally, except for recapture items, the sale, exchange or other disposition of a unit will result in capital gain or loss measured by the difference between the tax basis in the unit and the amount realized. Effective for property placed in service after December 31, 1986, the amount of gain, if any, realized upon the disposition of oil and gas property is treated as ordinary income up to the amount of intangible drilling and development costs incurred with respect to the property and depletion claimed to the extent it reduced the taxpayer's basis in the property. Under this provision, depletion attributable to a unit acquired after 1986 will be subject to recapture as ordinary income upon disposition of the unit or upon disposition of the oil and gas property to which the depletion is attributable. The balance of any gain or any loss will be capital gain or loss if the unit was held by the unitholder as a capital asset, either long-term or short-term depending on the holding period of the unit. This capital gain or loss will be long-term if a unitholder's holding period exceeds one year at the time of sale or exchange. Under current law, the highest marginal U.S. federal income tax rate applicable to long-term capital gains of individuals is 20%. Moreover, this rate is subject to change by new legislation at any time. The deductibility of capital losses are subject to certain limitations. Capital gain or loss will be short-term if the unit has not been held for more than one year at the time of sale or exchange.

Additional Tax on Net Investment Income

Individuals, estates, and trusts with income above certain thresholds are subject under Section 1411 of the Code to an additional 3.8% tax also known as the Net Investment Income Tax ("NIIT") on their net investment income. Grantor trusts such as Mesa Royalty Trust are not subject to the NIIT; 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 the units.

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Non-U.S. Unitholders

In general, a unitholder who is a nonresident alien individual or which is a foreign corporation, each a "non-U.S. unitholder" for purposes of this discussion, will be subject to tax on the gross income (without taking into account any deductions, such as depletion) produced by the Royalty at a rate equal to 30% or, if applicable, at a lower treaty rate. This tax will be withheld by the Trustee and remitted directly to the U.S. Treasury. A non-U.S. unitholder may elect to treat Royalty income as effectively connected with the conduct of a U.S. trade or business under provisions of the Code or pursuant to any similar provisions of applicable treaties. Upon making this election, a non-U.S. unitholder is entitled to claim all deductions with respect to that income, but he must file a U.S. federal income tax return to claim these deductions. This election once made is irrevocable unless an applicable treaty allows the election to be made annually.

The Code and the Treasury Regulations thereunder treat the publicly traded Trust as if it were a U.S. real property holding corporation. Accordingly, a non-U.S. unitholder may be subject to U.S. federal income tax on the gain on the disposition of his units if he meets certain ownership thresholds.

In addition, if a foreign corporation elects under provisions of the Code to treat Royalty income as effectively connected with the conduct of a U.S. trade or business, the corporation may also be subject to the U.S. branch profits tax at a rate of 30%. This tax is imposed on U.S. branch profits of a foreign corporation that are not reinvested in the U.S. trade or business, and is in addition to the tax on effectively connected income. The branch profits tax may be either reduced or eliminated by treaty. Federal income taxation of a non-U.S. unitholder is a highly complex matter which may be affected by many considerations. Therefore, each non-U.S. unitholder is encouraged to consult with his own tax advisor with respect to its ownership of Trust units.

Pursuant to the Foreign Account Tax Compliance Act (commonly referred to as "FATCA"), distributions from the Trust to "foreign financial institutions" and certain other "non-financial foreign entities" may be subject to U.S. withholding taxes. Specifically, certain "withholdable payments" (including certain royalties, interest and other gains or income from U.S. sources) made to a foreign financial institution or non-financial foreign entity will generally be subject to the withholding tax unless the foreign financial institution or non-financial foreign entity complies with certain information reporting, withholding, identification, certification and related requirements imposed by FATCA. Foreign financial institutions located in jurisdictions that have an intergovernmental agreement with the U.S. governing FATCA may be subject to different rules. Foreign unitholders are encouraged to consult their own tax advisors regarding the possible implications of these withholding provisions on their investment in Trust units.

Tax-Exempt Organizations

The Royalty and interest income should not be "unrelated business taxable income" (as defined in Code § 512(b)), so long as, generally, a unitholder did not incur debt to acquire a unit or otherwise incur or maintain a debt that would not have been incurred or maintained if the unit had not been acquired. Legislative proposals have been made from time to time which, if adopted, would result in the treatment of Royalty income as unrelated business taxable income. Each tax-exempt unitholder is encouraged to consult its own advisor with respect to the treatment of Royalty income.

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DESCRIPTION OF ROYALTY PROPERTIES

Producing Acreage and Wells as of December 31, 2017:

	Producing Acres(1)		Producing Gas Wells(1)	
	Gross	Net	Gross	Net
Hugoton Royalty Properties (Kansas)	99,654	99,413	463	402
San Juan Basin Royalty Properties (Northwestern New Mexico and Southwestern Colorado)	40,716	31,328	2,620	299
Total	140,370	130,741	3,083	701

(1) The Trust does not have a working interest in the producing acres and producing gas wells. The gross and net amounts in the table above represent gross and net amounts attributable to the Working Interest Owners and are the basis for the Gross Proceeds amounts discussed under "Description of the Trust".

Hugoton Royalty Properties

The principal property interest conveyed to the Trust accounts was carved out of Linn's working interest in 104,437 net producing acres in the Hugoton field of Kansas. The life of the field is expected to extend beyond the year 2042.

The natural gas produced from the Hugoton properties is available for sale on the spot market. See "Contracts". Since the Hugoton field gas is sold in the intrastate and interstate markets, it is subject to state and federal laws and regulations. The Kansas Corporation Commission is the state regulatory agency responsible for overseeing oil and gas operations in the state of Kansas. Hugoton field gas is also affected by the rules and regulations of the Federal Energy Regulatory Commission (the "FERC"). See "Regulation and Prices".

San Juan Basin Royalty Properties

The Trust's interest in the San Juan Basin Royalty Properties was conveyed from PNR's working interest in 31,328 net producing acres in Northwestern New Mexico and Southwestern Colorado. PNR completed the San Juan Basin Sale to ConocoPhillips on April 30, 1991. ConocoPhillips subsequently sold its underlying interest in substantially all of the San Juan Basin Colorado Properties 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 San Juan Basin Colorado Properties to BP. Starting from the date of the San Juan Basin Sale and ending on July 31, 2017, ConocoPhillips operated substantially all of the San Juan Basin New Mexico Properties, except for an immaterial number of properties assigned to XTO effective January 1, 2005. On July 31, 2017, ConocoPhillips sold its San Juan Basin assets to Hilcorp San Juan LP ("Hilcorp"), an affiliate of Hilcorp Energy Company. Substantially all of the natural gas produced from the San Juan Basin is currently being sold on the spot market. See "Description of the Trust".

Drilling

There were no exploratory wells drilled on any Royalty Properties during 2017, 2016, or 2015.

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Reserves

A study of the proved oil and gas reserves covering the Hugoton and San Juan Basin Royalty Properties (the "Reserve Report") and attributable to the Trust has been made by DeGolyer and MacNaughton, independent petroleum engineering consultants, as of December 31, 2017. A copy of this Reserve Report has been filed as Exhibit 99.1 to this Form 10-K. DeGolyer and MacNaughton is a Delaware corporation with offices in Dallas, Houston, Astana, Moscow and Algiers. The firm's more than 150 professionals include engineers, geologists, geophysicists, petrophysicists, and economists engaged in the appraisal of oil and gas properties, evaluation of hydrocarbon and other mineral prospects, basin evaluations, comprehensive field studies, and equity studies related to the domestic and international energy industry. DeGolyer and MacNaughton restricts its activities exclusively to consultation; it does not accept contingency fees, nor does it own operating interests in any oil, gas, or mineral properties, or securities or notes of clients. The firm subscribes to a code of professional conduct, and its employees actively support their related technical and professional societies. In serving the petroleum industry and financial community, the firm's experienced staff provides knowledge, independent judgment, integrity, and confidential service to its clients. The firm is a Texas Registered Engineering Firm, No. F-716.

The President at DeGolyer and MacNaughton primarily responsible for overseeing the preparation of the Reserve Report is a Registered Professional Engineer in the State of Texas with more than 35 years of experience in oil and gas reservoir studies and reserve evaluations. He graduated with a degree in Civil Engineering from Texas A&M University in 1979 and he is a member of the Society of Petroleum Engineers and the Society of Petroleum Evaluation Engineers.

The Reserve Report reflects estimated production, reserve quantities and future net revenue based upon estimates of the future timing of actual production without regard to when received in cash by the Trust, which differs from the manner in which the Trust recognizes and accounts for its Royalty income.

Estimates of the gross and net proved reserves, as of December 31, 2017, of the Trust's ownership in the net overriding royalty interests in the Royalty Properties are presented below. Total liquid reserves (condensate and natural gas liquids) are expressed in thousands of barrels (Mbbl) and gas reserves are expressed in thousands of cubic feet (Mcf).

	BP	Hilcorp	Linn	Total(1)
Proved Developed				
Oil and Condensate	0	8	0	8
Natural Gas Liquids	0	287	73	360
Gas	1,281	3,678	1,351	6,310
Proved Undeveloped				
Oil and Condensate	0	0	0	0
Natural Gas Liquids	0	0	0	0
Gas	0	0	0	0
Total, Proved				
Oil and Condensate	0	8	0	8
Natural Gas Liquids	0	287	73	360
Gas	1,281	3,678	1,351	6,310

(1) Data from Red Willow and XTO was omitted in the Reserve Report, because each operates an immaterial number of wells relative to the total number of wells currently producing from the Royalty Properties. Excess production costs related to Red Willow and XTO as of December 31, 2017 and 2016 are included in Net Proceeds paid to the Trust by Red Willow and XTO.

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The estimated future net revenue and standardized measure of future net royalty income, discounted at 10 percent per annum attributable to the Trust's Royalty as of December 31, 2017 is summarized in the table below. These estimates are provided based upon the economic assumptions furnished by the Working Interest Owners, and are expressed in thousands of dollars: