

CROSS TIMBERS ROYALTY TRUST

Form 10-Q

October 27, 2009

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**Form 10-Q**

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

**For the quarterly period ended September 30, 2009**

**OR**

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

**Commission File Number: 1-10982**

**Cross Timbers Royalty Trust**

**(Exact name of registrant as specified in its charter)**

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**Texas**  
(State or other jurisdiction of  
incorporation or organization)  
**U.S. Trust, Bank of America**  
**Private Wealth Management**

**75-6415930**  
(I.R.S. Employer  
Identification No.)

**P.O. Box 830650, Dallas, Texas**  
(Address of principal executive offices)

**75283-0650**  
(Zip Code)

**(877) 228-5084**  
(Registrant's telephone number, including area code)

**NONE**

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant 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  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 (check one):

Large accelerated filer  Accelerated filer   
Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company   
Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2). Yes  No

Indicate the number of units of beneficial interest outstanding, as of the latest practicable date:

Outstanding as of October 1, 2009

6,000,000

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**CROSS TIMBERS ROYALTY TRUST**

**FORM 10-Q FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2009**

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**CROSS TIMBERS ROYALTY TRUST**

**GLOSSARY OF TERMS**

The following are definitions of significant terms used in this Form 10-Q:

<i>Bbl</i>	Barrel (of oil)
<i>Mcf</i>	Thousand cubic feet (of natural gas)
<i>MMBtu</i>	One million British Thermal Units, a common energy measurement
<i>net proceeds</i>	Gross proceeds received by XTO Energy from sale of production from the underlying properties, less applicable costs, as defined in the net profits interest conveyances
<i>net profits income</i>	Net proceeds multiplied by the applicable net profits percentage of 75% or 90%, which is paid to the trust by XTO Energy. Net profits income is referred to as royalty income for income tax purposes.
<i>net profits interest</i>	An interest in an oil and gas property measured by net profits from the sale of production, rather than a specific portion of production. The following defined net profits interests were conveyed to the trust from the underlying properties:
	<i>90% net profits interests</i> B interests that entitle the trust to receive 90% of the net proceeds from the underlying properties that are royalty or overriding royalty interests in Texas, Oklahoma and New Mexico
	<i>75% net profits interests</i> B interests that entitle the trust to receive 75% of the net proceeds from the underlying properties that are working interests in Texas and Oklahoma
<i>royalty interest (and overriding royalty interest)</i>	A nonoperating interest in an oil and gas property that provides the owner a specified share of production without any production expense or development costs
<i>underlying properties</i>	XTO Energy's interest in certain oil and gas properties from which the net profits interests were conveyed. The underlying properties include royalty and overriding royalty interests in producing and nonproducing properties in Texas, Oklahoma and New Mexico, and working interests in producing properties located in Texas and Oklahoma.
<i>working interest</i>	An operating interest in an oil and gas property that provides the owner a specified share of production that is subject to all production expense and development costs

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**CROSS TIMBERS ROYALTY TRUST**

**PART I - FINANCIAL INFORMATION**

*Item 1. Financial Statements.*

The condensed financial statements included herein are presented, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in annual financial statements have been condensed or omitted pursuant to such rules and regulations, although the trustee believes that the disclosures are adequate to make the information presented not misleading. These condensed financial statements should be read in conjunction with the financial statements and the notes thereto included in the trust's latest Annual Report on Form 10-K. In the opinion of the trustee, all adjustments, consisting only of normal recurring adjustments, necessary to present fairly the assets, liabilities and trust corpus of the Cross Timbers Royalty Trust at September 30, 2009, and the distributable income and changes in trust corpus for the three- and nine-month periods ended September 30, 2009 and 2008, have been included. Distributable income for such interim periods is not necessarily indicative of distributable income for the full year.

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Bank of America, N.A., as Trustee

for the Cross Timbers Royalty Trust:

We have reviewed the accompanying condensed statement of assets, liabilities and trust corpus of the Cross Timbers Royalty Trust as of September 30, 2009 and the related condensed statements of distributable income and changes in trust corpus for the three- and nine-month periods ended September 30, 2009 and 2008. These condensed financial statements are the responsibility of the trustee.

We conducted our review in accordance with standards established by the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

The accompanying condensed financial statements are prepared on a modified cash basis as described in Note 1 which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

Based on our review, we are not aware of any material modifications that should be made to the condensed financial statements referred to above for them to be in conformity with the basis of accounting described in Note 1.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the statement of assets, liabilities and trust corpus of the Cross Timbers Royalty Trust as of December 31, 2008, and the related statements of distributable income and changes in trust corpus for the year then ended (not presented herein), included in the trust's 2008 Annual Report on Form 10-K, and in our report dated February 25, 2009, we expressed an unqualified opinion on those financial statements. In our opinion, the information set forth in the accompanying condensed statement of assets, liabilities and trust corpus as of December 31, 2008 is fairly stated, in all material respects, in relation to the statement of assets, liabilities and trust corpus included in the trust's 2008 Annual Report on Form 10-K from which it has been derived.

KPMG LLP

Fort Worth, Texas  
October 26, 2009

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**CROSS TIMBERS ROYALTY TRUST**

**Condensed Statements of Assets, Liabilities and Trust Corpus**

	<b>September 30, 2009</b>	<b>December 31, 2008</b>
	(Unaudited)	
<b>ASSETS</b>		
Cash and short-term investments	<b>\$ 1,162,331</b>	\$ 1,514,797
Interest to be received	<b>13</b>	467
Net profits interests in oil and gas properties - net (Note 1)	<b>16,669,252</b>	17,255,761
	<b>\$ 17,831,596</b>	\$ 18,771,025
<b>LIABILITIES AND TRUST CORPUS</b>		
Distribution payable to unitholders	<b>\$ 1,162,344</b>	\$ 1,515,264
Trust corpus (6,000,000 units of beneficial interest authorized and outstanding)	<b>16,669,252</b>	17,255,761
	<b>\$ 17,831,596</b>	\$ 18,771,025

The accompanying notes to condensed financial statements are an integral part of these statements.

**Table of Contents****CROSS TIMBERS ROYALTY TRUST****Condensed Statements of Distributable Income (Unaudited)**

	<b>Three Months Ended September 30</b>		<b>Nine Months Ended September 30</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
Net profits income	<b>\$ 2,894,511</b>	\$ 9,163,997	<b>\$ 8,089,015</b>	\$ 24,578,205
Interest income	<b>29</b>	7,221	<b>183</b>	18,255
Total income	<b>2,894,540</b>	9,171,218	<b>8,089,198</b>	24,596,460
Administration expense	<b>129,458</b>	57,008	<b>365,632</b>	335,658
Distributable income	<b>\$ 2,765,082</b>	\$ 9,114,210	<b>\$ 7,723,566</b>	\$ 24,260,802
Distributable income per unit (6,000,000 units)	<b>\$ 0.460847</b>	\$ 1.519035	<b>\$ 1.287261</b>	\$ 4.043467

The accompanying notes to condensed financial statements are an integral part of these statements.



**Table of Contents****CROSS TIMBERS ROYALTY TRUST****Condensed Statements of Changes in Trust Corpus (Unaudited)**

	<b>Three Months Ended September 30</b>		<b>Nine Months Ended September 30</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
Trust corpus, beginning of period	<b>\$ 16,922,528</b>	\$ 17,830,889	<b>\$ 17,255,761</b>	\$ 18,387,752
Amortization of net profits interests	<b>(253,276)</b>	(305,668)	<b>(586,509)</b>	(862,531)
Distributable income	<b>2,765,082</b>	9,114,210	<b>7,723,566</b>	24,260,802
Distributions declared	<b>(2,765,082)</b>	(9,114,210)	<b>(7,723,566)</b>	(24,260,802)
Trust corpus, end of period	<b>\$ 16,669,252</b>	\$ 17,525,221	<b>\$ 16,669,252</b>	\$ 17,525,221

The accompanying notes to condensed financial statements are an integral part of these statements.

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**CROSS TIMBERS ROYALTY TRUST**

**Notes to Condensed Financial Statements (Unaudited)**

**1. Basis of Accounting**

The financial statements of Cross Timbers Royalty Trust are prepared on the following basis and are not intended to present financial position and results of operations in conformity with U.S. generally accepted accounting principles ( GAAP ):

- Net profits income recorded for a month is the amount computed and paid by XTO Energy Inc., the owner of the underlying properties, to Bank of America, N.A., as trustee for the trust. Net profits income consists of net proceeds received by XTO Energy from the underlying properties in the prior month, multiplied by net profit percentages of 90% for the 90% net profits interests, and 75% for the 75% net profits interests.

Costs deducted in the calculation of net proceeds for the 90% net profits interests generally include applicable taxes, transportation, marketing and legal costs, and do not include production expense or development costs. For the 75% net profits interests, costs deducted in the calculation of net proceeds include production expense, development costs, applicable taxes, transportation, marketing and legal costs, operating charges and other costs.

- Net profits income is computed separately for each of five conveyances under which the net profits interests were conveyed to the trust. If monthly costs exceed revenues for any conveyance, such excess costs must be recovered, with accrued interest, from future net proceeds of that conveyance and cannot reduce net proceeds from the other conveyances.
- Interest income, interest to be received and distribution payable to unitholders include interest to be earned from the monthly record date (last business day of the month) through the date of the next distribution to unitholders.
- Trust expenses are recorded based on liabilities paid and cash reserves established by the trustee for liabilities and contingencies.
- Distributions to unitholders are recorded when declared by the trustee.

The financial statements of the trust differ from those prepared in conformity with U.S. GAAP because revenues are recognized when received rather than accrued in the month of production, expenses are recognized when paid rather than when incurred, and certain cash reserves may be established for contingencies which would not be accrued under U.S. GAAP. This comprehensive basis of accounting other than U.S. GAAP corresponds to the accounting permitted for royalty trusts by the U.S. Securities and Exchange Commission, as specified by Staff Accounting Bulletin Topic 12:E, Financial Statements of Royalty Trusts.

Most accounting pronouncements apply to entities whose financial statements are prepared in accordance with U.S. GAAP, directing such entities to accrue or defer revenues and expenses in a period other than when such revenues were received or expenses were paid. Because the trust s financial statements are prepared on the modified cash basis, as described above, most accounting pronouncements are not applicable to the trust s financial statements.

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In May 2009, the Financial Accounting Standards Board established general standards of accounting for and disclosures of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. The new rule sets forth the period after the balance sheet date during which management should evaluate any events or transactions for potential recognition or disclosure in the financial statements, the circumstances under which an entity should recognize such events or transactions in its financial statements, and the disclosures that an entity should make about such events or transactions. We have evaluated subsequent events through October 26, 2009.

In December 2008, the Securities and Exchange Commission (SEC) released Final Rule, *Modernization of Oil and Gas Reporting*. The new disclosure requirements include provisions that permit the use of new technologies to determine proved reserves if those technologies have been demonstrated empirically to lead to reliable conclusions about reserves volumes. The new requirements also will allow companies to disclose their probable and possible reserves to investors. In addition, the new disclosure requirements call for companies to: (a) report the independence and qualifications of its reserves preparer or auditor; (b) file reports when a third party is relied upon to prepare reserves estimates or conducts a reserves audit; and (c) report oil and gas reserves using an average price based upon the prior 12-month period rather than year-end prices. The new disclosure requirements are effective for financial statements for fiscal years ending on or after December 31, 2009. The effect of adopting the SEC rule has not been determined, but it is not expected to have a significant effect on the trust's reported financial position or distributable income.

The initial carrying value of the net profits interests of \$61,100,449 represents XTO Energy's historical net book value on February 12, 1991, the creation date of the trust. Amortization of the net profits interests is calculated on a unit-of-production basis and is charged directly to trust corpus. Accumulated amortization was \$44,431,197 as of September 30, 2009 and \$43,844,688 as of December 31, 2008.

## **2. Contingencies**

Several states have enacted legislation to require state income tax withholding from nonresident recipients of oil and gas proceeds. After consultation with its state tax counsel, XTO Energy has advised the trustee that it believes the trust is not subject to these withholding requirements. However, regulations are subject to change by the various states, which could change this conclusion. Should the trust be required to withhold state taxes, distributions to the unitholders would be reduced by the required amount, subject to the unitholder's right to file a state tax return to claim any refund due.

## **3. Lawsuit Settlements**

Certain of the underlying properties are involved in various lawsuits and certain governmental proceedings arising in the ordinary course of business. XTO Energy has advised the trustee that it does not believe that the ultimate resolution of these claims will have a material effect on trust annual distributable income, financial position or liquidity.

In the first nine months of 2008, the calculation of net profits income included lawsuit settlements of \$2,430,326 related to underpayment of royalties on underlying properties in the San Juan Basin. Included in these settlements was interest of \$1,024,815 and additional gas revenue of \$1,405,511. The total settlements, net to the trust, were \$2,187,294, or \$0.36 per unit.

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Significantly lower oil prices and elevated costs caused costs to exceed revenues on properties underlying the Texas working interest for January through April 2009 and on properties underlying the Oklahoma working interest for February through April 2009. However, these excess costs did not reduce net proceeds from the remaining conveyances. XTO Energy advised the trustee that increased oil prices and decreased costs led to the full recovery of excess costs, plus accrued interest, during third quarter 2009, on properties underlying the Texas and Oklahoma working interests. Excess costs, plus accrued interest, recovered during third quarter 2009 totaled \$128,359 (\$96,269 net to the trust) on properties underlying the Texas working interest and \$278,671 (\$209,003 net to the trust) on properties underlying the Oklahoma working interest. Interest paid on these excess costs totaled \$6,995 (\$5,246 net to the trust) for the nine months ended September 30, 2009.

*Item 2. Trustee's Discussion and Analysis.*

The following discussion should be read in conjunction with the trustee's discussion and analysis contained in the trust's 2008 annual report, as well as the condensed financial statements and notes thereto included in this Quarterly Report on Form 10-Q. The trust's Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports are available on the trust's web site at [www.crosstimberstrust.com](http://www.crosstimberstrust.com).

**Distributable Income***Quarter*

For the quarter ended September 30, 2009, net profits income was \$2,894,511 compared to \$9,163,997 for third quarter 2008. This 68% decrease in net profits income is primarily the result of lower oil and gas prices, recovery of excess costs, plus accrued interests, on the Texas and Oklahoma working interests properties in third quarter 2009 and increased production expense, partially offset by lower taxes, transportation and other costs and lower development costs. See **Net Profits Income** and **Excess Costs** below.

After considering interest income of \$29 and administration expense of \$129,458, distributable income for the quarter ended September 30, 2009 was \$2,765,082, or \$0.460847 per unit of beneficial interest. Changes in interest income are attributable to fluctuations in net profits income and interest rates. Administrative expense for the quarter increased 127% primarily because of the timing of expenditures. For third quarter 2008, distributable income was \$9,114,210, or \$1.519035 per unit. Distributions to unitholders for the quarter ended September 30, 2009 were:

<b>Record Date</b>	<b>Payment Date</b>	<b>Distribution per Unit</b>
July 31, 2009	August 14, 2009	\$ 0.107027
August 31, 2009	September 15, 2009	0.160096
September 30, 2009	October 15, 2009	0.193724
		\$ 0.460847

*Nine Months*

For the nine months ended September 30, 2009, net profits income was \$8,089,015 compared to \$24,578,205 for the same 2008 period. This 67% decrease in net profits income is primarily the result of lower oil and gas prices, lawsuit settlement proceeds included in the first nine months of 2008, increased production expense and decreased oil and gas sales volumes, partially offset by lower taxes, transportation and other costs and lower

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development costs. See Net Profits Income and Other Proceeds below.

After considering interest income of \$183 and administration expense of \$365,632, distributable income for the nine months ended September 30, 2009 was \$7,723,566, or \$1.287261 per unit of beneficial interest. Changes in interest income are attributable to fluctuations in net profits income and interest rates. Administrative expense for the nine months ended September 30, 2009 increased 9% from the prior year nine-month period primarily because of the timing of expenditures. For the nine months ended September 30, 2008, distributable income was \$24,260,802, or \$4.043467 per unit.

**Net Profits Income**

Net profits income is recorded when received by the trust, which is the month following receipt by XTO Energy and generally two months after oil production and three months after gas production. Net profits income is generally affected by three major factors:

- oil and gas sales volumes,
  
- oil and gas sales prices, and
  
- costs deducted in the calculation of net profits income.

Because properties underlying the 90% net profits interests are royalty and overriding royalty interests, they generally bear no costs other than production and property taxes, related legal costs, and marketing and transportation charges. In addition to these costs, the 75% net profits interests are subject to production expense and development costs, since the properties underlying the 75% net profits interests are working interests.

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The following is a summary of the calculation of net profits income received by the trust:

	Three Months			Nine Months		
	Ended September 30 (a)	2008	Increase (Decrease)	Ended September 30 (a)	2008	Increase (Decrease)
	2009			2009		
<b>Sales Volumes</b>						
Oil (Bbls) (b)						
Underlying properties	55,548	56,223	(1%)	166,439	172,693	(4%)
Average per day	604	611	(1%)	610	630	(3%)
Net profits interests	19,121	35,749	(47%)	50,018	103,249	(52%)
Gas (Mcf) (b)						
Underlying properties	507,886	527,589	(4%)	1,483,900	1,578,963	(6%)
Average per day	5,581	5,798	(4%)	5,436	5,763	(6%)
Net profits interests	444,683	468,863	(5%)	1,295,472	1,385,956	(7%)
<b>Average Sales Prices</b>						
Oil (per Bbl)	\$ 56.90	\$ 123.68	(54%)	\$ 46.18	\$ 100.96	(54%)
Gas (per Mcf) (c)	\$ 5.34	\$ 12.69	(58%)	\$ 5.61	\$ 11.65	(52%)
<b>Revenues</b>						
Oil sales	\$ 3,160,874	\$ 6,953,498	(55%)	\$ 7,686,233	\$ 17,435,366	(56%)
Gas sales (c)	2,711,361	6,694,294	(59%)	8,331,316	18,398,606	(55%)
Total Revenues	5,872,235	13,647,792	(57%)	16,017,549	35,833,972	(55%)
<b>Costs</b>						
Taxes, transportation and other	852,440	1,531,571	(44%)	2,514,090	3,905,058	(36%)
Production expense (d)	1,268,146	989,266	28%	3,945,513	3,272,794	21%
Development costs	79,665	413,713	(81%)	502,129	1,192,910	(58%)
Excess cost (e)	407,030	-	-	6,995	-	-
Total Costs	2,607,281	2,934,550	(11%)	6,968,727	8,370,762	(17%)
<b>Other Proceeds</b>						
Interest Income (c)	-	-	-	-	1,024,815	(100%)
<b>Net Proceeds</b>	<b>\$ 3,264,954</b>	<b>\$ 10,713,242</b>	<b>(70%)</b>	<b>\$ 9,048,822</b>	<b>\$ 28,488,025</b>	<b>(68%)</b>
<b>Net Profits Income</b>	<b>\$ 2,894,511</b>	<b>\$ 9,163,997</b>	<b>(68%)</b>	<b>\$ 8,089,015</b>	<b>\$ 24,578,205</b>	<b>(67%)</b>

(a) Because of the interval between time of production and receipt of royalty income by the trust, (1) oil and gas sales for the quarter ended September 30 generally represent oil production for the period May through July and gas production for the period April through June and (2) oil and gas sales for the nine months ended September 30 generally represent oil production for the period November through July and gas production for the period October through June.

(b) Oil and gas sales volumes are allocated to the net profits interests based upon a formula that considers oil and gas prices and the total amount of production expense and development costs. Changes in any of these factors may result in disproportionate fluctuations in volumes allocated to the net profits interests. Therefore, comparative discussion of oil and gas sales volumes is based on the underlying properties.

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- (c) In the nine-months ended September 30, 2008, \$2,430,326 was received related to lawsuit settlements for underpayment of royalties on certain San Juan Basin properties. Included in these settlements was interest of \$1,024,815. These settlements increased the average gas sales price by \$0.89 for the nine-months ended September 30, 2008. The total settlements, net to trust, were \$2,187,294, or \$0.36 per unit. See Note 3 to Consolidated Financial Statements.
  
- (d) Production expense is primarily from seven working interest properties in the 75% net profits interest. Six of these properties are not operated by XTO Energy. Production expense includes an overhead charge which is deducted and retained by XTO Energy. As of September 30, 2009, this charge was \$33,919 per month (including a monthly overhead charge of \$2,743 which XTO Energy deducts as operator of the Penwell Unit) and is subject to adjustment each May based on an oil and gas industry index.
  
- (e) See Note 4 to Condensed Financial Statements.

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The following are explanations of significant variances on the underlying properties from third quarter 2008 to third quarter 2009 and from the first nine months of 2008 to the comparable period in 2009:

### **Sales Volumes**

#### *Oil*

Oil sales volumes decreased 1% for third quarter 2009 and 4% for the first nine months of 2009 as compared with the same 2008 periods primarily because of the timing of cash receipts and natural production decline, partially offset by increased production from new wells and workovers.

#### *Gas*

Gas sales volumes decreased 4% for third quarter 2009 and 6% for the first nine months of 2009 as compared with the same 2008 periods. Decreased gas sales volumes for the quarter are primarily because of net prior period adjustments in 2009 and natural production decline, partially offset by the timing of cash receipts and increased production from new wells and workovers. Decreased gas sales volumes for the nine-month period are primarily because of the timing of cash receipts, natural production decline and net prior period adjustments in 2009, partially offset by increased production from new wells and workovers.

### **Sales Prices**

#### *Oil*

The average oil price decreased 54% to \$56.90 per Bbl for the third quarter and 54% to \$46.18 per Bbl for the nine-month period. Lower demand as a result of the global economic situation and rising crude oil supplies caused oil prices to decline in the first part of 2009. However, signs of possible economic improvement have resulted in higher recent oil prices. Oil prices are expected to remain volatile. The third quarter 2009 oil price is primarily related to production from May through July 2009, when the average NYMEX price was \$64.49 per Bbl. The average NYMEX price for August and September 2009 was \$70.16 per Bbl. At October 15, 2009, the average NYMEX futures price for the following twelve months was \$80.02 per Bbl. Recent trust oil prices have averaged approximately 12% lower than the NYMEX price.

#### *Gas*

Gas prices for the third quarter decreased 58% to \$5.34 per Mcf and for the nine-month period decreased 52% to \$5.61 per Mcf. Excluding the effects of the lawsuit settlement in the first nine months of 2008, the average gas price was \$10.76 per Mcf. See *Other Proceeds* below. Due to higher than average gas in storage caused by shale gas development and declining demand due to the U.S. recession, gas prices have declined. Prices will continue to be affected by the level of North American production, weather, oil prices, the U.S. economy, storage levels and import levels of liquified natural gas. Natural gas prices are expected to remain volatile. The third quarter 2009 gas price is primarily related to production from April through June 2009, when the average NYMEX price was \$3.50 per MMBtu. The average NYMEX price for July and August 2009 was \$3.66 per MMBtu. At October 15, 2009, the average NYMEX futures price for the following twelve months was \$5.75 per MMBtu. Recent trust gas prices have been approximately 31% higher than the NYMEX price.



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### **Costs**

#### *Taxes, Transportation and Other*

Taxes, transportation and other decreased 44% for the third quarter and 36% for the nine-month period primarily because of decreased production taxes related to lower oil and gas revenues, partially offset by increased other deductions as a percentage of oil and gas revenues.

#### *Production*

Production expense increased 28% for the third quarter and 21% for the first nine months of 2009 primarily due to increased overhead costs on nonoperated properties and increased outside operated costs, repairs and maintenance and carbon dioxide injection costs.

#### *Development*

Development costs decreased 81% for the third quarter and 58% for the nine-month period primarily because of decreased activity and costs related to Texas and Oklahoma properties underlying the 75% net profits interests.

#### *Excess Costs*

Significantly lower oil prices and elevated costs caused costs to exceed revenues on properties underlying the Texas working interest for January through April 2009 and on properties underlying the Oklahoma working interest for February through April 2009. However, these excess costs did not reduce net proceeds from the remaining conveyances. XTO Energy advised the trustee that increased oil prices and decreased costs led to the full recovery of excess costs, plus accrued interest, during third quarter 2009, on properties underlying the Texas and Oklahoma working interests. Excess costs, plus accrued interest, recovered during third quarter 2009 totaled \$128,359 (\$96,269 net to the trust) on properties underlying the Texas working interest and \$278,671 (\$209,003 net to the trust) on properties underlying the Oklahoma working interest. Interest paid on these excess costs totaled \$6,995 (\$5,246 net to the trust) for the nine months ended September 30, 2009.

### **Contingencies**

Several states have enacted legislation to require state income tax withholding from nonresident recipients of oil and gas proceeds. After consultation with its state tax counsel, XTO Energy has advised the trustee that it believes the trust is not subject to these withholding requirements. However, regulations are subject to change by the various states, which could change this conclusion. Should the trust be required to withhold state taxes, distributions to the unitholders would be reduced by the required amount, subject to the unitholder's right to file a state tax return to claim any refund due.

### **Other Proceeds**

In the first nine months of 2008, the calculation of net profits income included lawsuit settlements of \$2,430,326 related to underpayment of royalties on underlying properties in the San Juan Basin. Included in these settlements was interest of \$1,024,815 and additional gas revenue of \$1,405,511. The total settlements, net to the trust, were \$2,187,294, or \$0.36 per unit.

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### **New Accounting Pronouncements**

In May 2009, the Financial Accounting Standards Board established general standards of accounting for and disclosures of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. The new rule sets forth the period after the balance sheet date during which management should evaluate any events or transactions for potential recognition or disclosure in the financial statements, the circumstances under which an entity should recognize such events or transactions in its financial statements, and the disclosures that an entity should make about such events or transactions. We have evaluated subsequent events through October 26, 2009.

In December 2008, the Securities and Exchange Commission (SEC) released Final Rule, *Modernization of Oil and Gas Reporting*. The new disclosure requirements include provisions that permit the use of new technologies to determine proved reserves if those technologies have been demonstrated empirically to lead to reliable conclusions about reserves volumes. The new requirements also will allow companies to disclose their probable and possible reserves to investors. In addition, the new disclosure requirements call for companies to: (a) report the independence and qualifications of its reserves preparer or auditor; (b) file reports when a third party is relied upon to prepare reserves estimates or conducts a reserves audit; and (c) report oil and gas reserves using an average price based upon the prior 12-month period rather than year-end prices. The new disclosure requirements are effective for financial statements for fiscal years ending on or after December 31, 2009. The effect of adopting the SEC rule has not been determined, but it is not expected to have a significant effect on the trust's reported financial position or distributable income.

### **Forward-Looking Statements**

This report on 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 fact included in this Form 10-Q including, without limitation, statements regarding the net profits interests, underlying properties, development activities, development, production and other costs and expenses, oil and gas prices and differentials to NYMEX prices, distributions to unitholders, and industry and market conditions, are forward-looking statements that are subject to risks and uncertainties which are detailed in Part I, Item 1A of the trust's Annual Report on Form 10-K for the year ended December 31, 2008, which is incorporated by this reference as though fully set forth herein. Although XTO Energy and the trustee believe that the expectations reflected in such forward-looking statements are reasonable, neither XTO Energy nor the trustee can give any assurance that such expectations will prove to be correct.

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

There have been no material changes in the trust's market risks from the information disclosed in Part II, Item 7A of the trust's annual report on Form 10-K for the year ended December 31, 2008 other than the addition of the market risk described below:

Currently, cash held by the trustee as a reserve for liabilities and for the payment of expenses and distributions to unitholders is invested in Bank of America, N.A. certificates of deposit which are backed by the good faith and credit of Bank of America, N.A., but are only insured by the Federal Deposit Insurance Corporation up to \$250,000. Each unitholder should independently assess the creditworthiness of Bank of America, N.A. For more information about the credit rating of Bank of America, N.A., please refer to its periodic filings with the SEC. The trust does not lend money and has limited ability to borrow money, which the trustee believes limits the trust's risk from the currently tight credit markets. The trust's future royalty income, however, may be subject to risks relating to the creditworthiness of the operators of the underlying properties and other purchasers of crude oil and natural gas produced from the underlying properties, as well as risks associated with fluctuations in the price of crude oil and natural gas. See Item 1A Risk Factors Cash held by the trustee

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is not fully insured by the Federal Deposit Insurance Corporation, and future royalty income may be subject to risks relating to the creditworthiness of third parties. Information contained in Bank of America, N.A.'s periodic filings with the SEC is not incorporated by reference into this quarterly report on Form 10-Q and should not be considered part of this report or any other filing that the trust makes with the SEC.

*Item 4. Controls and Procedures.*

As of the end of the period covered by this report, the trustee carried out an evaluation of the effectiveness of the trust's disclosure controls and procedures pursuant to Exchange Act Rules 13a-15 and 15d-15. Based upon that evaluation, the trustee concluded that the trust's disclosure controls and procedures are effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by the trust in the reports that it files or submits under the Securities Exchange Act of 1934 and are effective in ensuring that information required to be disclosed by the trust in the reports that it files or submits under the Securities Exchange Act of 1934 is accumulated and communicated to the trustee to allow timely decisions regarding required disclosure. In its evaluation of disclosure controls and procedures, the trustee has relied, to the extent considered reasonable, on information provided by XTO Energy. There has not been any change in the trust's internal control over financial reporting during the period covered by this report that has materially affected, or is reasonably likely to materially affect, the trust's internal control over financial reporting.

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**PART II - OTHER INFORMATION**

*Item 1.*

Not applicable.

*Item 1A. Risk Factors.*

Except as set forth below, there have been no material changes in the risk factors disclosed under Part I, Item 1A of the trust's annual report on Form 10-K for the year ended December 31, 2008.

***Cash held by the trustee is not fully insured by the Federal Deposit Insurance Corporation, and future royalty income may be subject to risks relating to the creditworthiness of third parties.***

Currently, cash held by the trustee as a reserve for liabilities and for the payment of expenses and distributions to unitholders is invested in Bank of America, N.A. certificates of deposit which are backed by the good faith and credit of Bank of America, N.A., but are only insured by the Federal Deposit Insurance Corporation up to \$250,000. Each unitholder should independently assess the creditworthiness of Bank of America, N.A. For more information about the credit rating of Bank of America, N.A., please refer to its periodic filings with the SEC. The trust does not lend money and has limited ability to borrow money, which the trustee believes limits the trust's risk from the currently tight credit markets. The trust's future royalty income, however, may be subject to risks relating to the creditworthiness of the operators of the underlying properties and other purchasers of crude oil and natural gas produced from the underlying properties, as well as risks associated with fluctuations in the price of crude oil and natural gas. Information contained in Bank of America, N.A.'s periodic filings with the SEC is not incorporated by reference into this quarterly report on Form 10-Q and should not be considered part of this report or any other filing that the trust makes with the SEC.

*Items 2 through 5.*

Not applicable.

*Item 6. Exhibits.*

- (a) Exhibits.

**Exhibit Number  
and Description**

- |      |  |
|------|--|
| (15) | Awareness letter of KPMG LLP   |
| (31) | Rule 13a-14(a)/15d-14(a) Certification   |
| (32) | Section 1350 Certification   |
| (99) | Items 1A, 7 and 7A to the Annual Report on Form 10-K for Cross Timbers Royalty Trust filed with the Securities and Exchange Commission on February 25, 2009 (incorporated herein by reference) |

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned thereunto duly authorized.

CROSS TIMBERS ROYALTY TRUST

By BANK OF AMERICA, N.A., TRUSTEE

By */s/* NANCY G. WILLIS  
Nancy G. Willis  
Vice President

XTO ENERGY INC.

Date: October 27, 2009

By */s/* LOUIS G. BALDWIN  
Louis G. Baldwin  
Executive Vice President  
and Chief Financial Officer