

TORCH ENERGY ROYALTY TRUST

Form 10-Q

May 11, 2006

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

(Mark One)

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

For the quarterly period ended March 31, 2006

**OR**

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

**Commission File Number 1-12474**

**Torch Energy Royalty Trust**

(Exact Name of Registrant as Specified in Its Charter)

**Delaware**

(State or Other Jurisdiction of  
Incorporation or Organization)

**74-6411424**

(I.R.S. Employer  
Identification Number)

Rodney Square North

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

19890

(Zip Code)

302/636-6016

Registrant's telephone number, including area code  
Not Applicable

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Nonaccelerated filer

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

As of April 12, 2006, 8.6 million Units of beneficial interest were outstanding.

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Certification pursuant to Section 906

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**TORCH ENERGY ROYALTY TRUST**  
**PART 1 FINANCIAL INFORMATION**

**Item I. Financial Statements**

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

**Introduction**

The financial statements included herein have been prepared by Torch, pursuant to an administrative service agreement between Torch and the Trust, pursuant to the rules and regulations of the Securities and Exchange Commission. Wilmington Trust Company serves as the trustee ( Trustee ) of the Trust pursuant to the trust agreement dated October 1, 1993. Certain information and footnote disclosures normally included in the annual financial statements have been omitted pursuant to such rules and regulations, although Torch believes that the disclosures are adequate to make the information presented not misleading. These financial statements should be read in conjunction with the December 31, 2005 financial statements and notes thereto included in the Trust s latest annual report on Form 10-K. In the opinion of Torch, all adjustments necessary to present fairly the assets, liabilities and trust corpus of the Trust as of March 31, 2006 and December 31, 2005, the distributable income and changes in trust corpus for the three-month periods ended March 31, 2006 and 2005 have been included. All such adjustments are of a normal recurring nature. The distributable income for such interim periods is not necessarily indicative of the distributable income for the full year.

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

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**TORCH ENERGY ROYALTY TRUST**

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

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

|  | March 31,<br>2006<br>(Unaudited) | December 31,<br>2005 |
|--|----------------------------------|----------------------|
| <b>ASSETS</b>  |                                  |                      |
| Cash   | \$ 1                             | \$ 1                 |
| Net profits interests in oil and gas properties (Net of accumulated amortization of \$159,360 and \$158,926 at March 31, 2006 and December 31, 2005, respectively) | 21,240                           | 21,674               |
|  | \$ 21,241                        | \$ 21,675            |
| <b>LIABILITIES AND TRUST CORPUS</b>  |                                  |                      |
| Trust expense payable  | \$ 250                           | \$ 234               |
| Trust corpus   | 20,991                           | 21,441               |
|  | \$ 21,241                        | \$ 21,675            |

See notes to financial statements.

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

|   | Three Months Ended March<br>31, |          |
|---|---------------------------------|----------|
|   | 2006                            | 2005     |
| Net profits income                              | \$ 3,216                        | \$ 1,837 |
| Infill Well Net Proceeds                        | 113                             | 274      |
|   | 3,329                           | 2,111    |
| General and administrative expenses             | 245                             | 222      |
| Interest expense                                | 81                              |          |
|   | 326                             | 222      |
| Distributable income                            | \$ 3,003                        | \$ 1,889 |
| Distributable income per Unit (8,600,000 Units) | \$ .35                          | \$ .22   |
| Distributions per Unit                          | \$ .35                          | \$ .22   |

See notes to financial statements.

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

|                                       | Three Months Ended March<br>31, |           |
|---------------------------------------|---------------------------------|-----------|
|                                       | 2006                            | 2005      |
| Trust corpus, beginning of period     | \$ 21,441                       | \$ 23,556 |
| Amortization of Net Profits Interests | (434)                           | (607)     |
| Distributable income                  | 3,003                           | 1,889     |
| Distributions to Unitholders          | (3,019)                         | (1,866)   |
| Trust corpus, end of period           | \$ 20,991                       | \$ 22,972 |

See notes to financial statements.



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Notes to Financial Statements

1. Trust Organization and Nature of Operations

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

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

The Trust will terminate upon the first to occur of (i) an affirmative vote of the holders of not less than 66-2/3% of the outstanding Units to liquidate the Trust; (ii) such time as the ratio of the cash amounts received by the Trust from the Net Profits Interests to administrative costs of the Trust is less than 1.2 to 1.0 for three consecutive quarters; (iii) March 1 of any year if it is determined based on a reserve report as of December 31 of the prior year that the present value of estimated pre-tax future net cash flows, discounted at 10%, of proved reserves attributable to the Net Profits Interests is equal to or less than \$25.0 million; or (iv) December 31, 2012. As of March 31, 2006, the Trust has not terminated as none of the aforementioned events have occurred. Upon termination of the Trust, the remaining assets of the Trust will be sold and the proceeds therefrom (after expenses) will be distributed to the unitholders ( Unitholders ). The sole purpose of the Trust is to hold the Net Profits Interests, to receive payments from TRC and Velasco, and to make payments to Unitholders. The Trust does not conduct any business activity.

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

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Notes to Financial Statements

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

In addition, the amounts paid to the Trust from the Robinson s Bend Field during any calendar quarter are subject to a volume limitation ( Volume Limitation ) equal to the gross proceeds from the sale of 912.5 MMcf of gas, less property, production, severance and related taxes and operating and development costs. Since the fourth quarter of 1995, production from the Underlying Properties in the Robinson s Bend Field has been less than the Volume Limitation. See Note 2 to the financial statements for an explanation of the Trust s method of accounting.

The Net Profits Interests also entitle the Trust to 20% of the Infill Well Net Proceeds (as defined herein) of wells drilled on the Underlying Properties since the Trust s establishment into formations in which the Trust has an interest, other than wells drilled to replace damaged or destroyed wells ( Infill Wells ). Infill Well Net Proceeds represent the aggregate gross revenues received from Infill Wells less the aggregate amount of the following Infill Well costs: i) property, production, severance and similar taxes; ii) development costs; iii) operating costs; and iv) interest on the recovered portion, if any, of the foregoing costs computed at a rate of interest announced publicly by Citibank, N.A. in New York as its base rate.

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

**2. Basis of Accounting**

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

- Revenues are recognized in the period in which amounts are received by the Trust. Therefore, revenues recognized during the three-month periods ended March 31, 2006 and 2005 are derived from oil and gas production sold during the three-month periods ended December 31, 2005 and 2004, respectively. General and administrative expenses are recognized on an accrual basis.

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Notes to Financial Statements

- Amortization of the Net Profits Interests is calculated on a unit-of-production basis and charged directly to trust corpus.
- Distributions to Unitholders are recorded when declared by the Trustee.
- An impairment loss is recognized when the net carrying value of the Net Profits Interests exceeds its fair market value. No impairment loss was recognized during the first quarters of 2006 and 2005.
- The financial statements of the Trust differ from financial statements prepared in accordance with GAAP because net profits income is not accrued in the period of production and amortization of the Net Profits Interests is not charged against operating results.
- Estimates and assumptions have been made in preparing the financial statements of the Trust in order for the financial statements to be in conformity with accounting principles generally accepted in the United States.

3. Federal Income Taxes

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

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

4. Distributions and Income Computations

Distributions are determined for each quarter and are based on the amount of cash available for distribution to Unitholders. Such amount (the Quarterly Distribution Amount) is equal to the excess, if any, of the cash received by the Trust, on the last day of the second month following the previous calendar quarter (or the next business day thereafter) ending prior to the dissolution of the Trust, from the Net Profits Interests then held by the Trust plus, with certain exceptions, any other cash receipts of the Trust during such quarter, subject to adjustments for changes made during such quarter in any cash reserves established for the payment of

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## Notes to Financial Statements

contingent or future obligations of the Trust. Based on the payment procedures relating to the Net Profits Interests, cash received by the Trust on the last day of the second month of a particular quarter from the Net Profits Interests generally represents proceeds from the sale of oil and gas produced from the Underlying Properties during the preceding calendar quarter. The Quarterly Distribution Amount for each quarter is payable to Unitholders of record on the last day of the second month of the calendar quarter unless such day is not a business day in which case the record date is the next business day thereafter. The Quarterly Distribution Amount is distributed within approximately ten days after the record date to each person who was a Unitholder of record on the associated record date.

## 5. Related Party Transactions

*Marketing Arrangements*

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

The Purchase Contract also provides that the minimum price paid by *TEMI* for gas production is \$1.70 per MMBtu adjusted annually for inflation ( *Minimum Price* ). When *TEMI* pays a purchase price based on the Minimum Price, it receives price credits ( *Price Credits* ) equal to the difference between the Index Price and the Minimum Price that it is entitled to deduct in determining the purchase price when the Index Price for gas exceeds the Minimum Price. No Price Credits were deducted in calculating the purchase price related to distributions received by Unitholders during the quarters ended March 31, 2006 and 2005. As of March 31, 2006, *TEMI* had no accumulated Price Credits.

In addition, if the Index Price for gas exceeds \$2.10 per MMBtu adjusted annually for inflation ( *Sharing Price* ), *TEMI* is entitled to deduct 50% of such excess ( *Price Differential* ) in calculating the purchase price. As a result of such Sharing Price arrangement, Net Proceeds attributable to the Underlying Properties during the three months ended March 31, 2006 and 2005 were reduced by \$4.7 million and \$2.4 million, respectively. *TEMI* has an annual option to discontinue the Minimum Price commitment. However, if *TEMI* discontinues the Minimum Price commitment, it will no longer be entitled to deduct the Price Differential in calculating the purchase price and will forfeit all accrued Price Credits. *TEMI* has not exercised its option to discontinue the Minimum Price commitment. The Minimum Price for Underlying Property production during 2005 and 2004 was \$1.77 per MMBtu and \$1.73 per MMBtu, respectively. The Sharing Price for Underlying Property production during 2005 and 2004 was \$2.18 per MMBtu and \$2.13 per MMBtu, respectively.

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Notes to Financial Statements

Gross revenues (before deductions for applicable gathering, treating and transportation charges) from TEMI included in the Net Proceeds calculations attributable to the Underlying Properties during the quarters ended March 31, 2006 and 2005 were \$7.4 million and \$5.0 million, respectively.

*Gathering, Treating and Transportation Arrangements*

The Purchase Contract entitles TEMI to deduct certain gas gathering, treating and transportation costs in calculating the purchase price for gas in the Robinson s Bend, Austin Chalk and Cotton Valley Fields. The amounts that may be deducted in calculating the purchase price for such gas are set forth in the Purchase Contract and are not affected by the actual costs incurred by TEMI to gather, treat and transport gas. In the Robinson s Bend Field, TEMI is entitled to deduct a gathering, treating and transportation fee of \$0.26 per MMBtu adjusted for inflation (\$0.298 and \$0.292 per MMBtu for 2005 and 2004 production, respectively), plus fuel usage equal to 5% of revenues pursuant to a gas gathering agreement. Additionally, a fee of \$0.05 per MMBtu, representing a gathering fee payable to a non-affiliate of TEMI, is deducted in calculating the purchase price for production from 68 of 394 wells in the Robinson s Bend Field. TEMI also deducts \$0.38 per MMBtu plus 17% of revenues in calculating the purchase price for production from the Austin Chalk Fields, as a fee to gather, treat and transport gas production. TEMI deducts from the purchase price for gas in the Cotton Valley Fields a transportation fee of \$0.045 per MMBtu for production attributable to certain wells. This transportation fee is paid to a third party. During the three months ended March 31, 2006 and 2005, such fees deducted from the Net Proceeds calculations, attributable to production during the three months ended December 31, 2005 and 2004, in the Robinson s Bend, Austin Chalk and Cotton Valley Fields, totaled \$0.6 million and \$0.4 million, respectively. No amounts for gathering, treating or transportation are deducted in calculating the purchase price from the Chalkley Field.

*Administrative Services Agreement*

Pursuant to the Trust Agreement, Torch and the Trust entered into an administrative services agreement effective October 1, 1993. The Trust is obligated, throughout the term of the Trust, to pay to Torch each quarter an administrative services fee for accounting, bookkeeping, informational and other services relating to the Net Profits Interests. The administrative services fee is \$87,500 per calendar quarter commencing October 1, 1993. The amount of the administrative services fee is adjusted annually based upon the change in the Producer s Price Index as published by the Department of Labor, Bureau of Labor Statistics. Administrative service charges during each of the three months ended March 31, 2006 and 2005 were \$0.1 million.

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Notes to Financial Statements

*Operator Overhead Fees*

A subsidiary of Torch operates certain oil and gas interests burdened by the Net Profits Interests. The Underlying Properties are charged, on the same basis as other third parties, for all customary expenses and costs reimbursements associated with these activities. Operator overhead fees deducted from the Net Proceeds computations for the Chalkley, Cotton Valley and Austin Chalk fields totaled \$47,000 and \$46,000 during the three months ended March 31, 2006 and 2005, respectively.

*Compensation of the Trustee and Transfer Agent*

The Trust Agreement provides that the Trustee be compensated for its administrative services, out of the Trust assets, in an annual amount of \$41,000, plus an hourly charge for services in excess of a combined total of 250 hours annually at its standard rate. In accordance with provisions in the Trust Agreement, the Trustee may increase its compensation for its administrative services as a result of unusual or extraordinary services rendered by the Trustee. During 2005, due to the impact of the Sarbanes-Oxley Act on the Trust, the Trustee increased its compensation for administrative services to \$80,000 per year. The Trustee is also entitled to reimbursement for out-of-pocket expenses. Additionally, the Trustee receives a transfer agency fee of \$5.00 annually per account (minimum of \$15,000 annually), subject to change each December, beginning December 1994, based upon the change in the Producer's Price Index as published by the Department of Labor, Bureau of Labor Statistics, plus \$1.00 for each certificate issued. Total administrative and transfer agent fees during the three months ended March 31, 2006 and 2005 were \$25,000 and \$14,000, respectively. The Trustee is also entitled to reimbursement for out-of-pocket expenses.

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**Three Months Ended March 31, 2006 Compared to Three Months Ended March 31, 2005**

Because a modified cash basis of accounting is utilized by the Trust, Net Proceeds attributable to the Underlying Properties for the three months ended March 31, 2006 and 2005 is derived from actual oil and gas produced during the three months ended December 31, 2005 and 2004, respectively. Oil and gas sales attributable to the Underlying Properties for such periods are as follows:

|                       | Three Months Ended March 31, |               |                |               |
|-----------------------|------------------------------|---------------|----------------|---------------|
|                       | 2006                         |               | 2005           |               |
|                       | Bbls<br>of Oil               | Mcf<br>of Gas | Bbls<br>of Oil | Mcf<br>of Gas |
| Chalkley Field        | 1,258                        | 299,627       | 1,428          | 333,388       |
| Robinson's Bend Field |                              | 456,756       |                | 468,196       |
| Cotton Valley Fields  | 268                          | 166,152       | 314            | 184,137       |
| Austin Chalk Fields   | 3,533                        | 46,541        | 4,399          | 49,250        |
|                       | 5,059                        | 969,076       | 6,141          | 1,034,971     |

For the three months ended March 31, 2006, net profits income was \$3.2 million, up 78% from net profits income of \$1.8 million for the same period in 2005. Such increase is mainly due to higher average oil and gas prices paid to the Trust during the quarter ended March 31, 2006.

Gas production attributable to the Underlying Properties in the Chalkley, Cotton Valley and Austin Chalk Fields was 512,320 Mcf and 566,775 during the quarter ended December 31, 2005 and 2004, respectively. Gas production attributable to the Underlying Properties in the Robinson's Bend Field was 456,756 Mcf and 468,196 Mcf during the quarter ended December 31, 2005 and 2004, respectively. Gas production decreased during 2005 as a result of normal production declines. Oil production attributable to the Underlying Properties for the quarters ended December 31, 2005 and December 31, 2004 was 5,059 Bbls and 6,141 Bbls, respectively.

The average price used to calculate Net Proceeds for gas, before gathering, treating and transportation deductions, during the three months ended March 31, 2006 was \$7.12 per MMBtu as compared to \$4.27 per MMBtu for the three months ended March 31, 2005. The average price used to calculate Net Proceeds for oil during the quarter ended March 31, 2006 was \$52.59 per Bbl as compared to \$41.40 per Bbl for the quarter ended March 31, 2005. When TEMI pays a purchase price for gas based on the Minimum Price (\$1.77 per MMBtu and \$1.73 per MMBtu for 2005 and 2004 production, respectively), TEMI receives Price Credits which it is entitled to deduct in determining the purchase price when the Index Price for gas exceeds the Minimum Price. No Price Credits were deducted in calculating the purchase price related to distributions received by Unitholders during the quarters ended March 31, 2006 and

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2005. As of March 31, 2006, TEMI had no accumulated Price Credits. Additionally, if the Index Price for gas exceeds the Sharing Price (\$2.18 per MMBtu and \$2.13 per MMBtu for 2005 and 2004 production, respectively), TEMI is entitled to deduct 50% of such excess in calculating the purchase price. The deduction of the Price Differential in calculating the purchase price had the effect of reducing distributions received by Unitholders during the three months ended March 31, 2006 and 2005 by \$4.7 million and \$2.4 million, respectively.

During the quarter ended March 31, 2006, Net Proceeds generated from the Net Profits Interests pertaining to the Robinson s Bend Field exceeded the Robinson s Bend Field Cumulative Deficit. Accordingly, distributions received by Unitholders during the quarter ended March 31, 2006 included approximately \$425,000 of Net Proceeds from the Net Profits Interests in the Robinson s Bend Field. During the quarter ended March 31, 2005, Net Proceeds generated from the Net Profits Interests pertaining to the Robinson s Bend Field was less than the Robinson s Bend Field Cumulative Deficit, which resulted in no Net Proceeds attributable to the Robinson s Bend Field for the quarter ended March 31, 2005.

During the quarters ended March 31, 2006 and 2005, the Trust distributed approximately \$113,000 and \$274,000, respectively, of Infill Well Net Proceeds pertaining to oil and gas sales during the quarters ended September 30, 2006 and 2005, respectively. Such Infill Wells are located in the Cotton Valley Fields and are operated by Samson Lone Star Limited Partnership.

Lease operating expenses and capital expenditures attributable to the Underlying Properties in the Chalkley, Cotton Valley and Austin Chalk Fields deducted in calculating distributions during the quarter ended March 31, 2006 and 2005 totaled \$0.8 million and \$0.6 million, respectively. With respect to the Robinsons Bend Field, lease operating expenses and capital expenditures of \$1.5 million and \$2.1 million were deducted in calculating the Net Proceeds payable to the Trust from the Robinson s Bend Field for the quarters ended March 31, 2006 and 2005, respectively. General and administrative expenses amounted to \$0.2 million for each of the three-month periods ending March 31, 2006 and 2005. These expenses primarily relate to administrative services provided by Torch and the Trustee and legal fees.

The foregoing resulted in distributable income of \$3.0 million, or \$0.35 per Unit, for the three months ended March 31, 2006, as compared to \$1.9 million, or \$.22 per Unit, for the same period in 2005. Cash distributions of \$3.0 million, or \$0.35 per Unit, were made during the quarter ended March 31, 2006 as compared to \$1.9 million, or \$0.22 per Unit, for the same period in 2005.



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Net profits income received by the Trust during the three month periods ended March 31, 2006 and 2005, derived from production sold during the three months ended December 31, 2005 and 2004, respectively, was computed as shown in the following table (in thousands):

|   | Three Months Ended March 31, 2006                                 |                             |          | Three Months Ended March 31, 2005                                 |                             |          |
|---|---|-----------------------------|----------|---|-----------------------------|----------|
|   | Chalkley,<br>Cotton<br>Valley<br>and<br>Austin<br>Chalk<br>Fields | Robinson s<br>Bend<br>Field | Total    | Chalkley,<br>Cotton<br>Valley<br>and<br>Austin<br>Chalk<br>Fields | Robinson s<br>Bend<br>Field | Total    |
| Oil and gas revenues                      | \$ 3,913  | \$ 2,937                    | \$ 6,850 | \$ 2,745  | \$ 1,834                    | \$ 4,579 |
| Direct operating expenses:                |   |                             |          |   |                             |          |
| Lease operating expenses and Property tax | 497   | 1,470                       | 1,967    | 570   | 1,508                       | 2,078    |
| Severance tax                             | 250   | 310                         | 560      | 193   | 167                         | 360      |
|   | 747   | 1,780                       | 2,527    | 763   | 1,675                       | 2,438    |
| Net proceeds before capital expenditures  | 3,166   | 1,157                       | 4,323    | 1,982   | 159                         | 2,141    |
| Capital expenditures                      | 313   | 51                          | 364      | 48  | 607                         | 655      |
|   | 2,853   | 1,106                       | 3,959    | 1,934   | (448)                       | 1,486    |
| Cumulative Deficit                        |   | (574)                       | (574)    |   |                             |          |
| Net proceeds                              | 2,853   | 532                         | 3,385    | 1,934   | (448)                       | 1,486    |
| Net profits percentage                    | 95%   | 95%                         | 95%      | 95%   |                             |          |
| Net profits income                        | \$ 2,710  | \$ 506                      | \$ 3,216 | \$ 1,837  | \$                          | \$ 1,837 |

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

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

All production from the Underlying Properties is sold pursuant to a Purchase Contract between TRC, Velasco and TEMI. Pursuant to the Purchase Contract, TEMI is obligated to purchase all net production attributable to the Underlying Properties for an Index Price, less certain other charges, which are calculated monthly. The Index Price calculation is based on market prices of oil and gas and therefore is subject to commodity price risk. The Purchase Contract expires upon termination of the Trust and provides a Minimum Price paid by TEMI for gas. The Minimum Price is adjusted annually for inflation and was \$1.77 per MMBtu and \$1.73 per MMBtu for 2005 and 2004

production, respectively. When TEMI pays a purchase price based on the Minimum Price, it receives Price Credits equal to the difference between the Index Price and the Minimum Price that it is entitled to deduct when the Index Price exceeds the Minimum Price. Additionally, if the Index Price exceeds the Sharing Price, TEMI is entitled to deduct such excess, the Price Differential. The Sharing Price was \$2.18 per MMBtu and \$2.13 per MMBtu for 2005 and 2004 production, respectively. TEMI has an annual option to discontinue the Minimum Price commitment. However, if TEMI discontinues the Minimum Price commitment, it

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will no longer be entitled to deduct the Price Differential and will forfeit all accrued Price Credits. TEMI has not exercised its option to discontinue the Minimum Price Commitment.

**Item 4. Controls and Procedures**

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

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

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PART II. OTHER INFORMATION

**ITEM 1. Legal Proceedings**

None.

**ITEM 1A. Risk Factors**

There have been no material changes to our risk factors since our annual report on Form 10-K for the year ended December 31, 2005.

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

None.

**ITEM 3. Defaults upon Senior Securities**

None.

**ITEM 4. Submission of Matters to a Vote of Security Holders**

None.

**ITEM 5. Other Information**

None.

**ITEM 6. Exhibits**

(a) Exhibits

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

4.1 Form of Torch Energy Royalty Trust Agreement. \*

4.2 Form of Louisiana Trust Agreement. \*

4.3 Specimen Trust Unit Certificate. \*

4.4 Designation of Ancillary Trustee. \*

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

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

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

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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.

TORCH ENERGY ROYALTY TRUST

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

By: /s/ Bruce L. Bisson

Bruce L. Bisson  
Vice President

Date: May 11, 2006

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

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**Exhibit Index**

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