TORCH ENERGY ROYALTY TRUST
Form 10-K
December 31, 2008

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2007

OR

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

Commission file number 1-12474
TORCH ENERGY ROYALTY TRUST
(Exact Name of Registrant as Specified in its Charter)

Delaware	**74-6411424**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**

Rodney Square North
1100 North Market Street
Wilmington, Delaware 19890
(Address of Principal Executive Offices; Zip Code)
(Registrant s Telephone number, Including Area Code)
(302) 636-6016

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 þ

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 þ

Indicated by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(b) 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 o No þ

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K 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. þ

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 o	Accelerated filer o	Non-accelerated filer þ	Smaller reporting company o

(Do not check if a smaller reporting company)

Indicated by checkmark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes o No þ

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant s most recently completed second fiscal quarter was $68.9 million.

At December 29, 2008, there were 8,600,000 Units of Beneficial Interest of the Trust outstanding.

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Torch Energy Royalty Trust

PART I

Item 1. Business

This document 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. All statements other than statements of historical facts included in this document, including without limitation, statements under Management s Discussion and Analysis of Financial Condition and Results of Operations regarding the financial position, estimated 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 variations are 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. Important factors that could cause actual results to differ materially from Torch s expectations (Cautionary Statements) are disclosed under Risk Factors elsewhere in this document. All subsequent written and oral forward-looking statements attributable to the Trust or persons acting on its behalf are expressly qualified by the Cautionary Statements.

General

The Trust was formed effective October 1, 1993 under the Delaware Statutory Trust Act pursuant to a trust agreement (Trust Agreement) among Wilmington Trust Company, not in its individual capacity but solely as trustee of the Trust (Trustee), Torch Royalty Company (TRC), Velasco Gas Company Ltd. (and its assigns, 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). Such Units were sold to the public through various underwriters in November 1993. The current working interest owners of the Underlying Properties are Torch Royalty Company, Torch E&P Company and Constellation Energy Partners LLC.

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 and has no officers, directors or employees. The Trust relies on third party service providers to perform administrative services for the Trust. Prior to April 1, 2008, Torch provided accounting, bookkeeping, informational and other services to the Trust related to the Net Profits Interests pursuant to an administrative services agreement effective October 1, 1993 (Administrative Services Agreement) and an oral arrangement after termination of the Administrative Services Agreement on January 29, 2008 through April 1, 2008.

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). TRC and Velasco receive payments reflecting the proceeds of oil and gas sold and aggregate these payments, deduct applicable costs and make payments to the Trustee each quarter for the amounts due to the Trust. Unitholders generally receive quarterly cash distributions relating to oil and gas produced and sold from the Underlying Properties and since the termination of the Trust the Trustee has established a reserve account pursuant to the Trust Agreement for certain ongoing and future costs and expenses of the Trust. Because no additional properties will be contributed to the Trust, the assets of the Trust deplete over time and a portion of each cash distribution made by the Trust is analogous to a return of capital.

Torch Energy Royalty Trust

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 productive formations.

Separate conveyances (Conveyances) were used to transfer the Net Profits Interests in each state. Net proceeds (Net Proceeds), 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 (excluding operating and development costs from the Robinson s Bend Field prior to January 1, 2003), are calculated separately for each Conveyance. If, during any period, costs and expenses deducted in calculating Net Proceeds exceed gross proceeds under a Conveyance, neither the Trust nor Unitholders are liable to pay such excess directly, but the Trust will receive no payments for distribution to Unitholders with respect to such Conveyance until future gross proceeds exceed future costs and expenses plus the cumulative excess of such costs and expenses not previously recouped by TRC and Velasco plus interest thereon. The complete definitions of Net Proceeds are set forth in the Conveyances.

The Trust received the affirmative vote of the Unitholders of more than 66 2/3% of the outstanding Units to terminate the Trust at the meeting of Unitholders held on January 29, 2008. Upon termination of the Trust, among other things, the Trustee is required to sell the Net Profits Interests. Specifically, pursuant to Section 9.03(e) of the Trust Agreement if the property of the Trust Estate (as defined in the Trust Agreement) has not been sold prior to the end of one calendar year following the termination date, the Trustee must cause such assets to be sold at public auction. As the Trust was terminated by a vote of the Unitholders on January 29, 2008 (the Termination Date), the Trustee anticipates it will continue to consult with the Trust s and Trustee s financial and legal advisors in preparing the sales process and obtaining the necessary information required for disclosure regarding the Units to carry out the sale requirement under Section 9.03(e) if such assets have not been sold prior to January 29, 2009. No assurances can be given that the Trustee will be able to sell the Net Profits Interests, or the price that will be distributed to Unitholders following such a sale. Such distributions could be below the market value of the Units. The Trust can give no assurances of the effect of the results of the affirmative vote to terminate the Trust by the Unitholders on the continued listing of the Units on the New York Stock Exchange (NYSE) or any other national quotation system.

As previously disclosed by the Trust in certain of its filings with the Securities and Exchange Commission (SEC), the Trust and the working interest owners of the Underlying Properties were involved in an arbitration proceeding relating to the proper calculation of the quarterly Net Profits Interests payments owed to the Trust following the termination of the Trust. The working interest owners contended that the pricing mechanism contained in the terminated Purchase Contract (including the sharing price and minimum price mechanism) should continue to be utilized to calculate the quarterly Net Profits Interests payments. In the arbitration proceeding, the Trustee, not in its individual capacity but solely as Trustee of the Trust, contended that the sharing price mechanism of the Purchase Contract (which determined the calculation of the Net Profits Interests prior to the termination of the Oil and Gas Purchase Contract) did not survive the termination of the Purchase Contract or the termination of the Trust. On April 11, 2008, Trust Venture Company, LLC, which owns the majority of Units in the Trust, submitted an unopposed request to intervene in the arbitration and became a party to the arbitration. Trust Venture Company, LLC agreed with the Trustee, and has taken the position in the arbitration, that the sharing price mechanism of the Purchase Contract did not survive the termination of the Purchase Contract or the termination of the Trust.

The hearing on the merits in the arbitration commenced on June 16, 2008 and was completed on June 20, 2008. On July 18, 2008, JAMS, through a panel of three arbitrators (Arbitrators), released an award notice to all parties (the Award Notice). In the Award Notice, the Arbitrators found that the Conveyances are not ambiguous and the pricing mechanism of the Purchase Contract is incorporated by reference into the Conveyances notwithstanding termination of the Purchase Contract. The Arbitrators therefore concluded that the pricing mechanism (including the sharing price and minimum price mechanism) continues to burden the Net Profits Interests and will do so for the life of the Conveyances. The Arbitrators also denied each party s request for fees and costs; each party must bear its own fees and costs related to the arbitration. The Trust and Trustee incurred expenses as a result of the arbitration and expect to continue to incur expenses, including but not limited to legal fees, as a result of the winding up of the Trust. See also Item 3. Legal Proceedings for subsequent event information concerning the arbitration and Award Notice.

Marketing Arrangements

In connection with the formation of the Trust, TRC, Velasco and TEMI entered into the Purchase Contract, which expired upon the termination of the Trust. Under the Purchase Contract, which was in effect during the periods presented in this report, 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 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 TEMI pay a minimum price (Minimum Price) for gas production. The Minimum Price is adjusted annually for inflation and was $1.83, $1.80 and $1.77 per MMBtu for 2007, 2006 and 2005, respectively. 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. In addition, if the Index Price for gas exceeds the sharing price, which is adjusted annually for inflation (Sharing Price), TEMI is entitled to deduct 50% of such excess (Price Differential) in determining the purchase price. The Sharing Price was $2.26, $2.22 and $2.18 per MMBtu in 2007, 2006 and 2005, 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.

Gas production is purchased at the wellhead. Therefore, Net Proceeds do not include any amounts received in connection with extracting natural gas liquids from such production at gas processing or treating facilities.

Gathering, Treating and Transportation Arrangements

The Purchase Contract entitles TEMI to deduct certain gas gathering, treating and transportation fees 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. For the Robinson s Bend Field, TEMI is entitled to deduct a gathering, treating and transportation fee of $0.260 per MMBtu adjusted for inflation ($0.308, $0.303 and $0.298 per MMBtu for 2007, 2006, and 2005, respectfully), plus fuel usage equal to 5% of revenues. Additionally, a fee of $.05 per MMBtu, representing a gathering fee payable to a non-affiliate of Torch, is deducted in calculating the purchase price for production from 73 of the 423 wells in the Robinson s Bend Field. TEMI 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 for production attributable to certain wells in the Cotton Valley Fields a transportation fee of $0.045 per MMBtu. During the years ended December 31, 2007, 2006 and 2005, gathering, treating and transportation fees deducted from the Net Proceeds calculations pertaining to production during the twelve months ended September 30, 2007, 2006 and 2005 in the Robinson s Bend, Austin Chalk and Cotton Valley Fields, totaled $1.5 million, $1.7 million and $1.6 million for 2007, 2006 and 2005, respectively. No amounts for gathering, treating or transportation are deducted in calculating the purchase price from the Chalkley Field.

On February 5, 2008, the Trust and Trustee confirmed the existence of the Second Amendment to the Water Gathering and Disposal Agreement dated November 30, 2004 entered into by Robinson s Bend Operating Company, LLC, a Delaware company, successor in interest to Torch Energy Associates, Ltd., a Texas limited partnership (Producer), and Everlast Energy LLC, a Delaware company, successor in interest to Velasco Gas Company Ltd., a Texas limited partnership, (Gatherer) (the Second Amendment). The Second Amendment provides that Section 3.1 of the Water Gathering and Disposal Agreement entered into as of August 9, 1990, by and between Producer s and Gatherer s respective predecessors in interest, as amended by the First Amendment to Water Gathering and Disposal Agreement entered into as of October 1, 1993, by and between such parties was amended such that the Producer shall pay Gatherer a fee of $0.53 per barrel for gathering, separation and disposal of water until Trust terminates, at which point Producer shall pay Gatherer a fee of $1.00 per barrel for gathering, separation and disposal of water.

Neither the Trust nor the Trustee is a party to the Agreement or the Second Amendment and the Trust did not approve or ratify the Second Amendment. No assurance can be given of the effect of the Second Amendment on the Trust, its assets or the production costs chargeable to the Trust based on the Agreement. Pursuant to the net overriding royalty conveyance (Torch Energy Royalty Trust)(Alabama), certain production costs including second category costs as defined in the conveyance are chargeable to the Trust, provided that the costs and expenses paid by a working interest owner to an affiliate of the working interest owner and chargeable to the Trust for performing such operations or services shall not exceed competitive contract charges prevailing in the area for such operations or services. The Trust believes that the costs associated with the Agreement are considered second category costs and are likely subject to the competitive limitation noted above. The Trust is reviewing the appropriateness of this increase being passed through to the Trust.

Net Profits Interests

The Net Profits Interests entitle the Trust to receive 95% of the Net Proceeds attributable to oil and gas produced and sold from wells (other than infill wells) on the Underlying Properties. 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. The Robinson s Bend Field production attributable to the Trust did not meet the Volume Limitation during the years ended December 31, 2007, 2006 and 2005 and is not expected to do so in the future.

The Net Profits Interests also entitle the Trust to 20% of the Net Proceeds 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 Wells net proceeds

(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.

Availability of Reports

The Trust s Website address is 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 website referenced herein is not incorporated by reference into this report and does not constitute a part of this report.

Item 1A. Risk Factors

You should carefully consider the following risk factors in addition to the other information included in this report. The Trustee is in the process of winding up and liquidating the Trust after the affirmative vote of the requisite number of Unitholders. See Trust Termination below in this item. The other Risk Factors set forth below should be considered in light of the wind up and liquidation of the Trust. If any of these risks or uncertainties actually occur, the Trust s financial condition and results of operations and the future and current value of the Net Profits Interests could be materially adversely affected. Additional risks not presently known to the Trust or which the Trust considers immaterial based on information currently available to it may also materially adversely affect the Trust. Because of these factors, past financial performance should not be considered an indication of future performance.

Trust Termination

The Trust received the affirmative vote of the Unitholders of more than 66 2/3% of the outstanding Units to terminate the Trust at the meeting of Unitholders held on January 29, 2008. Upon termination of the Trust, among other things, the Trustee is required to sell the Net Profits Interests. No assurances can be given that the Trustee will be able to sell the Net Profits Interests, or that the ultimate proceeds that will be distributed to Unitholders following such a sale will be equivalent to the market value of such interests. Such distributions could be below the market value of the Units. The Trust and Trustee cannot anticipate the results that such termination of the Trust will have on its ability to sell the Net Profits Interests.

Specifically, pursuant to Section 9.03(e) of the Trust Agreement if the property of the Trust Estate (as defined in the Trust Agreement) has not been sold prior to the end of one calendar year following the termination date (prior to January 29, 2009), the Trustee must then cause such assets to be sold at public auction. As the Trust was terminated by a vote of the Unitholders on January 29, 2008 (the Termination Date), the Trustee anticipates it will continue to consult with the Trust s and Trustee s financial and legal advisors in preparing the sales process and obtaining the necessary information required for disclosure regarding the Units to carry out the sale requirement under Section 9.03(e) if such assets have not been sold prior to January 29, 2009. There can be no assurance at this time of the specific timetable in which the Trust and Trustee would be able to obtain all the information advisable and necessary concerning the Net Profits Interests in order to prepare and finalize the sales process should the property of the Trust Estate not be sold prior to January 29, 2009.

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The Trust s continuing failure to timely file certain periodic reports with the SEC during the wind up and liquidation of the Trust may pose significant risks to the Trust s business, which could materially and adversely affect the Trust financial condition and results of operation and the current and/or future value of the Net Profits Interests.

The public trading price for the Units tends to be tied to the recent and expected levels of cash distribution on the Units. The amounts available for distribution by the Trust vary in response to numerous factors outside the control of the Trust, including prevailing prices for natural gas produced from the Trust s Net Profits Interests. The market price is not necessarily indicative of the value that the Trust would realize if it sold those Net Profits Interests to a third party buyer. In addition, such market price is not necessarily reflective of the fact that since the assets of the Trust are depleting assets, a portion of each cash distribution paid on the units should be considered by investors as a return of capital, with the remainder being considered as a return on investment. There is no guarantee that distributions made to a Unitholder over the life of these depleting assets will equal or exceed the purchase price paid by the Unitholder. The Trust can give no assurances of the effect of the results of the affirmative vote to terminate the Trust by the Unitholders on the continued listing of the Units on the New York Stock Exchange (NYSE) or any other national quotation system. Failure of the Trust to make progress in its efforts to complete and file its SEC reports or failing to meet the minimum listing criteria of the NYSE could result in a suspension of the Trust s listing and trading privileges. If the NYSE does not grant the Trust extensions to file its periodic reports with the NYSE, it has the right to begin proceedings to delist the units. A delisting of the Trust s units may have a material adverse effect on the Trust, among other things reducing the liquidity and market price of the units.

If gas and oil prices decline significantly, the Trust s cash flow from operations will likely decline and the Trust may have to lower the cash distributions or may not be able to pay distributions at all during the wind up and liquidation of the Trust.

The Trust s cash distributions, operating results and the value of the Net Profits Interest are substantially dependent on prices of gas and, to a lesser extent, oil. Prices for oil and gas are volatile and are subject to large fluctuations in response to relatively minor changes in the supply of and demand for oil and gas, market uncertainty and a variety of additional factors beyond the control of the Trust and/or Torch. These factors include:

- The domestic and foreign supply of and demand for oil and gas;

- The price and quantity of foreign imports of oil and gas;

- The level of consumer product demand;

- Weather conditions, including but not limited to, hurricanes in the Gulf of Mexico, can adversely impact cash distributions received by the Trust. If the wells drilled on the Underlying Properties and related infrastructure were to be damaged by adverse weather conditions, cash flows distributed to Unitholders could be delayed during the period in which damage to such assets were repaired. Additionally, costs associated with such repairs not covered by insurance would reduce cash distributions received by the Trust;

- Overall domestic and global economic conditions;

- Political and economic conditions and events in foreign oil and gas producing countries, including embargoes, continued hostilities in the Middle East and other sustained military campaigns, conditions in South America and Russia, and acts of terrorism or sabotage;

- The ability of members of the Organization of Petroleum Exporting Countries to agree to and maintain oil price and production controls;

- Technological advances affecting energy consumption;

Domestic and foreign governmental regulations and taxation;

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- The impact of energy conservation efforts;
- The capacity of natural gas pipelines and other transportation facilities to the Trust s production; and
- The price and availability of alternative fuels.

Any substantial and extended decline in the price of gas and oil would have an adverse effect on the Trust s revenues, cash distributions and current and/or future value of the Net Profits Interests.

Trust expenses may have an adverse impact on the distributions to Unitholders during the wind up and liquidation of the Trust.

Trust expenses and legal fees during the wind down and liquidation of the Trust may have an adverse effect on the ability of the Trust to pay quarterly distributions to the Unitholders. The Trustee has set up a reserve account pursuant to the Trust Agreement in order to provide the funds necessary for an orderly wind up and liquidation of the Trust.

The estimated reserve quantities in this report are based on many assumptions that may prove to be inaccurate. Any material inaccuracies in these reserve estimates or underlying assumptions will materially affect the quantities and present value of the Trust s reserves.

Estimates of economically recoverable gas and oil reserves and of future net cash flows are based upon a number of variable factors and assumptions, all of which are to some degree speculative and may vary considerably from actual results. Prices for oil and gas are volatile and are subject to large fluctuations in response to relatively minor changes in the supply of and demand for oil and gas, market uncertainty and a variety of additional factors beyond the control of the Trust and/or Torch. Therefore, actual production, revenues, taxes and development and operation expenditures may not occur as estimated. Future results of the Trust will depend upon the ability of the owners of the Underlying Properties to develop, produce and sell their oil and natural gas reserves and the corresponding proceeds from such sales which may vary widely. The reserve data included herein are estimates only and are subject to many uncertainties. Actual quantities of oil and natural gas may differ considerably from the amounts set forth herein. In addition, different reserve engineers may make different estimates of reserve quantities and cash flows based upon the same available data. The present value, discounted at 10%, of future net cash flows from proved reserves attributable to the Net Profits Interests does not represent the fair market value of the proved reserves, or the price at which the Net Profits Interests could be sold. A determination of fair market value would involve consideration of many factors in addition to the present value, discounted at 10%. 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 years ended December 31, 2007, 2006 and 2005.

As more infill wells are drilled, they could cause a reduction in amounts payable to the Trust or a purchaser of the Net Profits Interests.

The Net Profits Interests include a 20 percent net profit interest in infill wells. Infill wells may recover a portion of the reserves that would otherwise be produced from wells burdened by the Trust s net profits interests. Since the Trust is entitled to receive 95 percent of the net proceeds from production burdened by its net profits interests but only 20 percent of the net profits from infill wells the drilling of infill wells may reduce payments to the Trust, and ultimately distributions to Trust Unitholders.

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The Trust s business is subject to operational risks that may not be fully insured, which, if they were to occur, could adversely affect the Trust s financial condition or results of operations and, as a result, the Trust s ability to pay distributions to Unitholders.

Cash payments to the Trust are derived from the production and sale of gas and oil, which operations are subject to risk inherent in such activities, such as blowouts, cratering, explosions, damage to equipment caused by weather conditions, facility or equipment malfunctions, uncontrollable flows of oil, gas or well fluids, fires, pollution and other environmental risks. These risks could result in substantial losses which are deducted in calculating the Net Proceeds paid to the Trust due to injury and loss of life, severe damage to and destruction of property and equipment, pollution and other environmental damage and suspension of operations. The Trust may elect not to obtain insurance if it believes that the cost of available insurance is excessive relative to the perceived risks presented. Losses could therefore occur for uninsurable or uninsured risks or in amounts in excess of existing insurance coverage. The occurrence of an event that is not fully covered by insurance could have a material adverse impact on the Trust s business activities, financial condition, results of operations and ability to pay distributions to Unitholders. The failure of an operator of the Underlying Properties to conduct its operations or discharge its obligations in a proper manner could have an adverse effect on the Net Proceeds payable to the Trust.

The Trust may be unable to compete effectively with larger companies, which may adversely affect the Trust s ability to generate sufficient revenue and its ability to pay distributions to Unitholders prior to the windup and liquidation of the Trust.

The Trust s distributions are dependent on gas production and prices and, to a lesser extent, oil production and prices from the Underlying Properties. The gas industry is highly competitive in all of its phases. In marketing production from the Underlying Properties, major gas companies, independent gas concerns, and individual producers and operators may provide competition. Many of these competitors have greater financial and other resources than the companies marketing the production of the Trust. Competition may also be presented by alternative fuel sources, including heating oil and other fossil fuels. In addition, the Trust and Trustee do not independently monitor the working interest owners financial viability on an ongoing basis which may have an effect on the Trust and its ability to pay distributions to the Unitholders.

The Trust s operations are subject to regulations which may limit the Trust s production of natural gas or the price that the Trust receives for natural gas.

The production, transportation and sale of natural gas from the Underlying Properties are subject to Federal and state governmental regulation, including regulation of tariffs charged by pipelines, taxes, the prevention of waste, the conservation of gas, pollution controls and various other matters. The United States has governmental power to impose pollution control measures.

If it is determined that the Trust is subject to the Texas margin tax, the Trustee may have to withhold a disproportionate amount from future distributions to pay the tax liability.

The Trustee does not intend to pay any amounts for the new Texas margin tax for tax year 2007, based on the assumption that the Trust is exempt from tax as a passive entity; however, there is currently no clear statutory authority that the Trust meets requirements for the margin tax exemption as a passive entity. If it is subsequently determined that the Trust is not exempt from the margin tax, the Trust would be required to deduct and withhold from future distributions the amounts necessary to pay the margin tax for the entire 2007 year, including the tax liability accruing on income distributed after December 2006

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attributable to 2007 Trust revenues from which no tax was withheld. For more information about the Texas margin tax, see Note 3 to the Trust s financial statements.

Federal Regulation

The Underlying Properties are subject to the jurisdiction of FERC with respect to various aspects of gas operations including the marketing and production of gas. The Natural Gas Act and the Natural Gas Policy Act (collectively, the Acts) mandate Federal regulation of interstate transportation of gas. The Natural Gas Wellhead Decontrol Act of 1989 terminated wellhead price controls on all domestic gas on January 1, 1993. Numerous questions have been raised concerning the interpretation and implementation of several significant provisions of the Acts and of the regulations and policies promulgated by FERC thereunder. A number of lawsuits and administrative proceedings have been instituted which challenge the validity of regulations implementing the Acts. In addition, FERC currently has under consideration various policies and proposals that may affect the marketing of gas under new and existing contracts. Accordingly, Torch is unable to predict the impact of any such government regulation.

In the past, Congress has been very active in the area of gas regulation. Legislation enacted in repeals incremental pricing requirements and gas use restraints previously applicable. At the present time, it is impossible to predict what proposals, if any, might actually be enacted by Congress or the various state legislatures and what effect, if any, such proposals might have on the Underlying Properties and the Trust.

State Regulation

Many state jurisdictions have at times imposed limitations on the production of gas by restricting the rate of flow for gas wells below their actual capacity to produce and by imposing acreage limitations for the drilling of a well. States may also impose additional regulations of these matters. Most states regulate the production of gas, including requirements for obtaining drilling permits, the method of developing new fields, provisions for the unitization or pooling of gas properties, the spacing, operation, plugging and abandonment of wells and the prevention of waste of gas resources. The rate of production may be regulated and the maximum daily production allowable from gas wells may be established on a market demand or conservation basis or both.

Because the Trust handles oil and gas petroleum products, the Trust may incur significant costs and liabilities in the future resulting from a failure to comply with new or existing environmental regulations or an accidental release of hazardous substances in the environment.

Activities on the Underlying Properties are subject to existing Federal, state and local laws, rules and regulations relating to the protection of public health and welfare, safety and the environment, including, without limitation, laws regulating the release of materials into the environment and laws protecting areas of particular environmental concern. It is anticipated that, absent the occurrence of an unanticipated event, compliance with these laws will not have a material adverse effect upon the Trust or Unitholders. Torch has informed the Trust that it cannot predict what effect future regulation or legislation, enforcement policies thereunder, and claims for damages to property, employees, other persons and the environment resulting from operations on the Underlying Properties could have on the Trust or Unitholders. However, pursuant to the terms of the Conveyances, any costs or expenses incurred by TRC or Velasco in connection with environmental liabilities, to the extent arising out of or relating to activities occurring on, or in connection with, or conditions existing on or under, the Underlying Properties before October 1, 1993, will be borne by TRC or Velasco and not the Trust and will not be deducted in calculating Net Proceeds and will, therefore, not reduce amounts payable to the Trust.

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Net Proceeds Attributable to the Robinson s Bend Field have declined significantly.

Prior to December 31, 2002, lease operating expenses were not deducted in calculating the Net Proceeds payable to the Trust from the Robinson s Bend Field. In accordance with the provisions of the Net Profits Interest conveyance covering the Robinson s Bend Field, commencing with the second quarter 2003 distribution (pertaining to the quarter ended March 31, 2003 production) lease operating expenses and capital expenditures have been deducted in calculating Net Proceeds. These expenses and expenditures are being reviewed by the Trust, including the Second Amendment of the Water Gathering and Disposal. The Trust receives no payments for distributions to Unitholders with respect to the Robinson s Bend Field when proceeds do not exceed the sum of costs and expenses and the cumulative excess of such costs and expenses including interest (Robinson s Bend Field Cumulative Deficit). The Trust received approximately $0.6 million in 2006 (pertaining to production during the twelve month period ended September 30, 2006) for payments for distributions to Unitholders with respect to the Robinson s Bend Field. The Trust received no payments for distributions to Unitholders with respect to the Robinson s Bend Field during the years ended December 31, 2005 and 2007.

The Robinson s Bend Field Cumulative Deficit at December 31, 2007 (pertaining to production as of September 30, 2007) was approximately $326,000. Neither the Trust nor Unitholders are liable to pay such deficit. However, the Trust will receive no payments with respect to the Robinson s Bend Field until future proceeds exceed the Robinson s Bend Cumulative Deficit.

The market price for the Trust s Units may not reflect the value of the Net Profits Interests held by the Trust.

The public trading price for the Trust Units tends to be tied to the recent and expected levels of cash distributions on the Trust Units. The amounts available for distribution by the Trust vary in response to numerous factors outside the control of the Trust, including prevailing prices for oil and natural gas produced from the Underlying Properties. The market price of the Trust Units is not necessarily indicative of the value that the Trust would realize if the Net Profits Interests were sold to a third party buyer. In addition, such market price is not necessarily reflective of the fact that, since the assets of the Trust are depleting assets, a portion of each cash distribution paid on the Trust Units should be considered by investors as a return of capital, with the remainder being considered as a return on investment. There is no guarantee that distributions made to a Unitholder over the life of these depleting assets will equal or exceed the purchase price paid by the Unitholder.

Financial information of the Trust is not prepared in accordance with GAAP.

The financial statements of the Trust are prepared on a modified cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the U.S., or GAAP. Although this basis of accounting is permitted for royalty trusts by the Securities and Exchange Commission, the financial statements of the Trust differ from GAAP financial statements because net profits income is not accrued in the month of production, expenses are not recognized when incurred and cash reserves may be established for certain contingencies that would not be recorded in GAAP financial statements.

The Trust is dependent on certain service providers to provide various services to the Trust.

The Trust relies on third party service providers to perform administrative services and other services for the Trust. Prior to April 1, 2008, Torch provided accounting, bookkeeping, informational and other services to the Trust related to the Net Profits Interests pursuant to an Administrative Services Agreement and an oral arrangement after termination of the Administrative Services Agreement on January 29, 2008 through April 1, 2008. If the Trust is not able to hire qualified services providers to assist in the wind up and liquidation of the Trust, such inability might have a material adverse effect on the operations of the Trust.

Unitholders have limited voting rights.

Voting rights as a Unitholder are more limited than those of stockholders of most public corporations. For example, there is no requirement for annual meetings of Unitholders or an annual or other periodic re-election of the Trustee. Unlike corporations which are generally governed by boards of directors elected by their equity holders, the Trust is administered by a corporate Trustee in accordance with the Trust Agreement and other organizational documents. The Trustee has extremely limited discretion in its administration of the Trust.

Item 1B. Unresolved Staff Comments

As of December 29, 2008, the Trust did not have any unresolved Securities and Exchange Commission staff comments.

Item 2. Properties

Description of the Underlying Properties

Chalkley Field. The Underlying Properties in the Chalkley Field, located in Cameron Parish, Louisiana, include an average 16.2% working interest (12.1% net revenue interest) in five unitized wells (excluding Infill Wells) producing from the Miogyp B reservoir. As of December 31, 2007, one Infill Well has been drilled on the Underlying Properties in the Chalkley Field. The average working interest and net revenue interest (net to the Trust s 20% interest) is approximately 3.2% and 2.4%. These wells produce from a depth in excess of 14,000 feet. A subsidiary of ExxonMobil Corporation operates the wells.

Robinson s Bend Field. The Underlying Properties include an average 39.8% working interest (30.2% net revenue interest) in 392 wells (excluding Infill Wells) in the Robinson s Bend Field in the Black Warrior Basin of Alabama. As of December 31, 2007, 31 Infill Wells have been drilled on the Underlying Properties in the Robinson s Bend Field. The average working interest and net revenue interest of the Robinson s Bend Infill Wells (net to the Trust s 20% interest) is approximately 6.7% and 5.1%, respectively. All of the wells in the Robinson s Bend Field are operated by a third party, Robinson s Bend Operating II, LLC.

Cotton Valley Fields. The Underlying Properties include an average 55.2% working interest (42.9% net revenue interest) in 41 wells (excluding Infill Wells) in four fields that produce from the Upper and Lower Cotton Valley formations in Texas. As of December 31, 2007, 31 Infill Wells have been drilled on the Underlying Properties in the Cotton Valley Fields. The average working interest and net revenue interest of the Cotton Valley Fields Infill Wells (net to the Trust s 20% interest) is approximately 13.9% and 11.2%, respectively. A subsidiary of Torch operates 40 of these wells. The remaining wells are operated by Samson Lone Star Limited Partnership (Samson).

Austin Chalk Fields. The Underlying Properties include an average of 17.6% working interest (14.0% net revenue interest) in 75 wells in the Austin Chalk Fields of Central Texas. Production from these fields is derived primarily from the highly fractured Austin Chalk formation using horizontal drilling techniques. A subsidiary of Torch operates two wells in the Austin Chalk Fields. The remaining wells in the Austin Chalk Fields are operated by third parties.

Oil and Gas Reserves

The pre-tax future net cash flows, discounted at 10%, attributable to the net proved reserves of the Net Profits Interests was approximately $30.9 million as of December 31, 2007. Future cash flows attributable to the Robinson s Bend Field s Net Profits Interest were estimated to have no value to the Trust as of December 31, 2007. See Note 6 of the audited financial statements for additional information concerning the net proved reserves of the Net Profits Interests.

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Well Count and Acreage Summary

The following table shows, as of December 31, 2007, the gross and net interest in oil and gas wells for the Underlying Properties:

	Gas Wells		Oil Wells	
	Gross	Net	Gross	Net
Chalkley Field	6	.8		
Robinson s Bend Field	423	170.2		
Cotton Valley Fields	72	25.2		
Austin Chalk Fields	33	5.7	42	7.7
Total	534	201.9	42	7.7

The following table shows the gross and net acreage for the Underlying Properties as of December 31, 2007. A gross acre in the following table refers to the number of acres in which a working interest is owned directly by the Trust. The number of net acres is the sum of the fractional ownership of working interests owned directly by the Trust in the gross acres expressed as a whole number and percentages thereof. A net acre is deemed to exist when the sum of fractional ownership of working interests in gross acres equals one.

	Acreage	
	Gross	Net
Chalkley Field	2,152	348
Robinson s Bend Field	33,404	14,288
Cotton Valley Fields	4,411	2,606
Austin Chalk Fields	28,364	5,090
Total	68,331	22,332

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Drilling Activity

The following table sets forth the results of drilling activity for the Underlying Properties during the three years ended December 31, 2007. Gross wells, as it applies to wells in the following table, refers to the number of wells in which a working interest is owned directly by the owners of the Underlying Properties and Infill Wells (Gross Well). A net well (Net Well) represents the sum of the fractional ownership working interests in the Gross Wells expressed as whole numbers and percentages thereof.

All of the wells shown below represent Infill Wells drilled on the Underlying Properties in the Chalkley Field, Cotton Valley Fields and the Robinson s Bend Field. The Net Profits Interest entitle the Trust to 20% of Infill Well Net Proceeds which is defined as gross proceeds from the sale of production attributable to Infill Wells less all production, drilling and completion costs of such wells. Infill Well Net Proceeds are calculated by aggregating the proceeds and costs from Infill Wells on a state by state basis.

	Development Wells Chalkley Field (a)					
	Gross			Net		
	Productive	Dry Holes	Total	Productive	Dry Holes	Total
2007	1	0	1	0.03	0	0.03
2006	0	0	0	0	0	0
2005	0	0	0	0	0	0

	Development Wells Cotton Valley Fields (b)					
	Gross			Net		
	Productive	Dry Holes	Total	Productive	Dry Holes	Total
2007	2	0	2	0.3	0	0.3
2006	4	0	4	0.6	0	0.6
2005	6	0	6	0.7	0	0.7

	Development Wells Robinson s Bend Field (c)					
	Gross			Net		
	Productive	Dry Holes	Total	Productive	Dry Holes	Total
2007	8	0	8	1.2	0	1.2
2006	12	0	12	0.6	0	0.6
2005	11	0	11	0.7	0	0.7

(a) The Trust has not received cash distributions with respect to the Infill Well drilled in the Chalkley Field. As of

December 31, 2007, costs and expenses exceeded gross revenues by approximately $3.0 million (before interest). The Trust will receive no payments for distributions with respect to the Chalkley Field Infill Well until the future proceeds exceed the sum of future costs and expenses and the cumulative excess of such costs and expenses including interest.

(b) The Trust received cash distributions of approximately $0.4 million during 2007 with respect to the Infill Wells drilled in the Cotton Valley Fields. As of December 31, 2007, costs and expenses exceeded gross revenues by approximately $0.2 million. The Trust will receive no payments for distributions with respect to the Cotton

Valley Fields Infill Wells until the future proceeds exceed the sum of future costs and expenses and the cumulative excess of such costs and expenses.

(c) The Trust has not received cash distributions with respect to the Infill Wells drilled in the Robinson s Bend Field. As of December 31, 2007, costs and expenses exceeded gross revenues by approximately $723,000. The Trust will receive no payments for distributions with respect to the Robinson s Bend Infill Wells until the future proceeds exceed the sum of future costs and expenses and the cumulative excess of such costs and expenses including interest.

There was no other drilling activity on the Underlying Properties during the three years ended December 31, 2007.

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Oil and Gas Sales Prices and Production Costs

The following table sets forth, for the Underlying Properties, the net production volumes of gas and oil, the weighted average lifting cost and taxes per Mcfe deducted in calculating Net Proceeds and the weighted average sales price per Mcf of gas and Bbl of oil for production attributable to cash distributions received by Unitholders during years ended December 31, 2007, 2006 and 2005 (derived from production during the twelve months ended September 30, 2007, 2006 and 2005, respectively).

	Chalkley, Cotton Valley And Austin Chalk Fields		
	2007	2006	2005
Production:			
Gas (MMcf)	1,811	1,955	2,088
Oil (Mbbl)	15	19	22
Weighted average lifting cost per Mcfe	$ 1.15	$ 1.01	$ .96
Weighted average taxes on production per Mcfe	$ .39	$ .42	$ .35
Weighted average sales price (a)	$ 4.29	$ 5.27	$ 4.45
Gas ($/Mcf)			
Oil ($/Bbl)	$57.51	$58.56	$46.14

	Robinson s Bend Field		
	2007	2006	2005
Production:			
Gas (MMcf)	1,667	1,762	1,826
Oil (Mbbl)			
Weighted average lifting cost per Mcfe	$ 3.59	$ 3.43	$ 3.22
Weighted average taxes on production per Mcfe	$ .34	$ .45	$ .36
Weighted average sales price (a)	$ 3.83	$ 4.71	$ 3.98
Gas ($/Mcf)			
Oil ($/Bbl)	$	$	$

(a) Average sales prices are reflective of purchase prices paid by TEMI, pursuant to the Purchase Contract, less certain gathering, treating and transportation charges.

Item 3. Legal Proceedings

On October 16, 2008, Trust Venture Company, LLC and Wilmington Trust Company, solely in its capacity as Trustee for the Torch Energy Royalty Trust, (together, Plaintiffs) filed a petition against Torch Royalty Company, Torch E&P

Company, and Constellation Energy Partners LLC (collectively, Defendants) in the District Court of Harris County, Texas. The petition sought to vacate the arbitration award issued by the JAMS Panel in Defendants favor on July 18, 2008 in the arbitration captioned Torch Royalty Co., et al. v. Wilmington Trust Co., et al., JAMS Reference No. 13100017310. See Item 1. Business General for a description of the arbitration. Defendants filed a motion to dismiss the Plaintiffs petition and to confirm the arbitration award. On or about December 10, 2008, the Court entered an Order dismissing the petition and granting the Defendants motion to confirm the arbitration award. Trust Venture Company, LLC and the Trustee are reviewing the Order and have the right to appeal the decision.

On December 22, 2008, the Trustee received a demand letter from Trust Venture Company, LLC with respect to certain enumerated costs including administrative costs and costs for water gathering, treating and disposal that are deducted by the working interest owners of the Underlying Properties from the Net Profit Interests before remitting the Net Proceeds to the Trustee and the Trust. Trust Venture Company, LLC has concluded that the Trust has been overcharged (and continues to be overcharged) by the working interest owners of certain of the Underlying Properties and that these overcharges have damaged the Trust

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(and as a result, all of the Trust s Unitholders). In addition, Trust Venture Company, LLC asserts that the working interest owners have failed to provide the required accountings as set forth in the Conveyances and that the Trust may request the court to require the working interest owners to provide such an accounting. Trust Venture Company, LLC requests that the Trustee either institute legal action against the working interest owners, or authorize Trust Venture Company, LLC to commence a derivative action against the current working interest owner of the Alabama property in accordance with, *inter alia*, Section 3816 of the Delaware Statutory Trust Act, codified at 12 Del. C. 3816(a), to recover all overcharges related to administrative costs, water gathering, treating and disposal costs and all overcharges reflected in the accounting. The Trustee responded on December 22, 2008 to Trust Venture Company, LLC with a request for additional information which it has now received. The Trustee carefully considered Trust Venture Company, LLC s demand letter, and has concluded, in the reasoned exercise of its business judgment, that it is in the best interest of the Trust and all Unit holders to authorize Trust Venture Company, LLC to commence a derivative action and provided its authorization as of December 30, 2008.

Item 4. Submission of Matters to a Vote of Unitholders

The Trust received the affirmative vote of the Unitholders of more than 66 2/3% of the outstanding Units to terminate the Trust at the meeting of Unitholders held on January 29, 2008. Upon termination of the Trust, among other things, the Trustee is required to sell the Net Profits Interests. Specifically, pursuant to Section 9.03(e) of the Trust Agreement if the property of the Trust Estate (as defined in the Trust Agreement) has not been sold prior to the end of one calendar year following the termination date, the Trustee must cause such assets to be sold at public auction. As the Trust was terminated by a vote of the Unitholders on January 29, 2008 (the Termination Date), the Trustee anticipates it will continue to consult with the Trust s and Trustee s financial and legal advisors in preparing the sales process and obtaining the necessary information required for disclosure regarding the units to carry out the sale requirement under Section 9.03(e) if such assets have not been sold by January 28, 2009. No assurances can be given that the Trustee will be able to sell the Net Profits Interests, or the price that will be distributed to Unitholders following such a sale. Such distributions could be below the market value of the Units.

The Trust can give no assurances of the effect of the results of the affirmative vote to terminate the Trust by the Unitholders on the continued listing of the units on the New York Stock Exchange (NYSE) or any other national quotation system.

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PART II

Item 5. Market for Registrant s Units and Related Unitholder Matters

The Units are listed and traded on the New York Stock Exchange under the symbol   TRU.   At March 1, 2008, there were 8,600,000 Units outstanding and approximately 224 Unitholders of record. The following table sets forth, for the periods indica