

SAN JUAN BASIN ROYALTY TRUST

Form 10-Q

August 09, 2011

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**Form 10-Q**

- ☐ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
For the Quarterly Period Ended June 30, 2011**
- 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 No. 1-8032**

**San Juan Basin Royalty Trust**

*(Exact name of registrant as specified in the Amended and Restated San Juan Basin Royalty Trust Indenture)*

**Texas**  
*(State or other jurisdiction of  
incorporation or organization)*

**75-6279898**  
*(I.R.S. Employer  
Identification No.)*

**Compass Bank**  
**2525 Ridgmar Boulevard, Suite 100**  
**Fort Worth, Texas 76116**  
*(Address of principal executive offices)*  
*(Zip Code)*

**(866) 809-4553**  
*(Registrant's telephone number, including area code)*

**N/A**  
*(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

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

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

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

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

Number of Units of beneficial interest outstanding at August 9, 2011: 46,608,796

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**SAN JUAN BASIN ROYALTY TRUST**

**PART I**

**FINANCIAL INFORMATION**

**Item 1. *Financial Statements.***

The condensed financial statements included herein have been prepared without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. The financial statements of the San Juan Basin Royalty Trust (the Trust ) continue to be prepared in a manner that differs from generally accepted accounting principles in the United States of America ( GAAP ); this form of presentation is customary to other royalty trusts. Certain information and footnote disclosures normally included in annual financial statements have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. Nonetheless, Compass Bank, the trustee of the Trust (the Trustee ), believes that the disclosures are adequate to make the information presented not misleading. These condensed financial statements should be read in conjunction with the financial statements and the notes thereto included in the Trust s Annual Report on Form 10-K for the year ended December 31, 2010. In the opinion of the Trustee, all adjustments, consisting only of normal recurring adjustments, have been included that are necessary to fairly present the assets, liabilities and trust corpus of the Trust at June 30, 2011 and the distributable income and changes in trust corpus for the three-month periods and six-month periods ended June 30, 2011 and 2010. The distributable income for such interim periods is not necessarily indicative of the distributable income for the full year.

## SAN JUAN BASIN ROYALTY TRUST

## CONDENSED STATEMENTS OF ASSETS, LIABILITIES AND TRUST CORPUS

	<b>June 30, 2011 (Unaudited)</b>	<b>December 31, 2010</b>
<b>ASSETS</b>		
Cash and short-term investments	\$ 5,914,592	\$ 5,223,123
Net overriding royalty interest in producing oil and gas properties (net of accumulated amortization of \$119,289,472 and \$118,529,644 at June 30, 2011 and December 31, 2010, respectively)	13,986,056	14,745,884
	<b>\$ 19,900,648</b>	<b>\$ 19,969,007</b>
<b>LIABILITIES AND TRUST CORPUS</b>		
Distribution payable to Unit Holders	\$ 5,758,803	\$ 5,067,334
Cash reserves	155,789	155,789
Trust corpus 46,608,796 Units of beneficial interest authorized and outstanding	13,986,056	14,745,884
	<b>\$ 19,900,648</b>	<b>\$ 19,969,007</b>

## CONDENSED STATEMENTS OF DISTRIBUTABLE INCOME (UNAUDITED)

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
Royalty income	\$ 15,568,211	\$ 22,450,139	\$ 30,957,341	\$ 44,452,655
Interest income	683,060	4,776	684,525	213,089
Total revenue	16,251,271	22,454,915	31,641,866	44,665,744
General and administrative expenditures	526,817	774,334	1,048,502	1,455,845
Distributable income	<b>\$ 15,724,454</b>	<b>\$ 21,680,581</b>	<b>\$ 30,593,364</b>	<b>\$ 43,209,899</b>
Distributable income per Unit (46,608,796 Units)	<b>\$ 0.337370</b>	<b>\$ 0.465161</b>	<b>\$ 0.656385</b>	<b>\$ 0.927076</b>

## CONDENSED STATEMENTS OF CHANGES IN TRUST CORPUS (UNAUDITED)

<b>Three Months Ended</b>	<b>Six Months Ended</b>
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	<b>June 30,</b>		<b>June 30,</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
Trust corpus, beginning of period	\$ 14,342,274	\$ 16,323,490	\$ 14,745,884	\$ 16,843,731
Amortization of net overriding royalty interest	(356,218)	(521,509)	(759,828)	(1,041,750)
Distributable income	15,724,454	21,680,581	30,593,364	43,209,899
Distributions declared	(15,724,454)	(21,680,581)	(30,593,364)	(43,209,899)
Trust corpus, end of period	\$ 13,986,056	\$ 15,801,981	\$ 13,986,056	\$ 15,801,981

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

## SAN JUAN BASIN ROYALTY TRUST

### NOTES TO CONDENSED FINANCIAL STATEMENTS (UNAUDITED)

#### 1. BASIS OF ACCOUNTING

The San Juan Basin Royalty Trust (the Trust ) was established as of November 1, 1980. The financial statements of the Trust are prepared on the following basis:

Royalty income recorded for a month is the amount computed and paid with respect to the Trust's 75% net overriding royalty interest (the Royalty ) in certain oil and gas leasehold and royalty interests (the Underlying Properties ) by Burlington Resources Oil & Gas Company LP ( BROG ), the present owner of the Underlying Properties, to the Trustee for the Trust. Royalty income consists of the proceeds received by BROG from the sale of production from the Underlying Properties less accrued production costs, development and drilling costs, applicable taxes, operating charges, and other costs and deductions, multiplied by 75%. The calculation of net proceeds by BROG for any month includes adjustments to proceeds and costs for prior months and impacts the Royalty income paid to the Trust and the distribution to Unit Holders for that month.

Trust expenses recorded are based on liabilities paid and cash reserves established from Royalty income for liabilities and contingencies.

Distributions to Unit Holders are recorded when declared by the Trustee.

The conveyance which transferred the Royalty to the Trust provides that any excess of development and production costs applicable to the Underlying Properties over gross proceeds from such properties must be recovered from future net proceeds before Royalty income is again paid to the Trust.

The financial statements of the Trust differ from financial statements prepared in accordance with GAAP because revenues are not accrued in the month of production; certain cash reserves may be established for contingencies which would not be accrued in financial statements prepared in accordance with GAAP; expenses are recorded when paid instead of when incurred; and amortization of the Royalty calculated on a unit-of-production basis is charged directly to the Trust corpus instead of as an expense. The basis of accounting used by the Trust is widely used by royalty trusts for financial reporting purposes.

#### 2. FEDERAL INCOME TAXES

For federal income tax purposes, the Trust constitutes a fixed investment trust which is taxed as a grantor trust. A grantor trust is not subject to tax at the trust level. The Unit Holders are considered to own the Trust's income and principal as though no trust were in existence. The income of the Trust is deemed to have been received or accrued by each Unit Holder at the time such income is received or accrued by the Trust rather than when distributed by the Trust.

Additionally, the Trust is a widely held fixed investment trust ( WHFIT ) classified as a non-mortgage widely held fixed investment trust ( NMWHFIT ) for federal income tax purposes. The Trustee is the representative of the Trust that will provide tax information in accordance with the applicable U.S. Treasury Regulations governing the information reporting requirements of the Trust as a WHFIT and a NMWHFIT.

The Royalty constitutes an economic interest in oil and gas properties for federal income tax purposes. Unit Holders must report their share of the production revenues of the Trust as ordinary income from oil and gas royalties and are

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entitled to claim depletion with respect to such income. The Royalty is treated as a single property for depletion purposes. The Trust has on file technical advice memoranda confirming such tax treatment.

Sales of gas production from certain coal seam wells drilled prior to January 1, 1993, qualified for federal income tax credits under Section 29 (now Section 45K) of the Internal Revenue Code of 1986 (as amended, the Code ) through 2002 but not thereafter. Accordingly, under present law, the Trust's production and sale of gas from coal seam wells does not qualify for tax credit under Section 45K of the Code (the Section 45 Tax Credit ). Congress has at various times since 2002 considered energy legislation, including provisions to reinstate the

## SAN JUAN BASIN ROYALTY TRUST

### NOTES TO CONDENSED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

Section 45 Tax Credit in various ways and to various extents, but no legislation that would qualify the Trust's current production for such credit has been enacted. For example, in December 2010, new energy tax legislation was enacted which, among other things, modified the Section 45 Tax Credit in several respects, but did not extend the credit for production from coal seam wells. No prediction can be made as to what future tax legislation affecting Section 45K of the Code may be proposed or enacted or, if enacted, its impact, if any, on the Trust and the Unit Holders. Each Unit Holder should consult his or her own tax advisor regarding tax compliance matters related to such Unit Holder's interest in the Trust.

The classification of the Trust's income for purposes of the passive loss rules may be important to a Unit Holder. As a result of the Tax Reform Act of 1986, royalty income such as that derived through the Trust will generally be treated as portfolio income that may not be offset or reduced by passive losses.

### 3. CONTINGENCIES

See Part II, Item 1 – Legal Proceedings, concerning the status of litigation matters.

### 4. SETTLEMENTS AND LITIGATION

On March 14, 2008, BROG notified the Trust that the distribution for March would be reduced by \$4,921,578. BROG described this amount as the Trust's portion of what BROG had paid to settle claims for the underpayment of royalties in the case styled United States of America ex rel. Harold E. (Gene) Wright v. AGIP Petroleum Co. et al., Civil Action No. 5:03CV264 (formerly 9:98-CV-30) (E.D. Tex.). The Trust's consultants continue to analyze this settlement as it may apply to the Trust.

Following mediation conducted on April 8 and 23, 2010, BROG and the Trust entered into a settlement of previously reported litigation styled San Juan Basin Royalty Trust vs. Burlington Resources Oil & Gas Company, L.P., No. D1329-CV-08-751, in the District Court of Sandoval County, New Mexico, 13th Judicial District. The dispute subject to the mediation arose out of an arbitrator's award in 2005 in favor of the Trust. That award effectively resolved five compliance audit issues, but BROG argued in subsequent litigation that one of those issues was beyond the scope of the matters agreed to be submitted to arbitration. Pursuant to the settlement, the litigation was dismissed, BROG paid \$2,600,000 to the Trust in May 2010, and released its claims for attorneys' fees.

BROG has informed the Trust that pursuant to an Order to Perform (the "MMS Order") issued by the Minerals Management Service ("MMS") dated June 10, 1998, the Jicarilla Apache Nation (the "Jicarilla") alleged that in valuing production for royalty purposes one must perform (i) a major portion analysis, which calculates value on the highest price paid or offered for a major portion of the gas produced from the field where the leased lands are situated; and (ii) a dual accounting calculation, which computes royalties on the greater of (a) the value of gas prior to processing or (b) the combined value of processed residue gas and plant products plus the value of any condensate recovered downstream without processing. The MMS Order alleged that BROG's dual accounting calculations on Native American leases were based on less than major portion prices. In December 2000, BROG and the Jicarilla entered into a settlement agreement resolving the issues associated with the dual accounting calculation. The major portion calculation issue remains outstanding. BROG takes the position that a judgment or settlement could entitle BROG to reimbursement from the Trust for past periods.



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According to BROG, on March 28, 2007 the Assistant Secretary of Indian Affairs of the United States Department of Interior issued an administrative order in BROG's appeal of the major portion calculation issue of the MMS Order entitled MMS-98-0141-IND Burlington Resources Oil & Gas Company LP (the Administrative Order). The Administrative Order rejected that portion of the MMS Order requiring BROG to calculate and pay additional royalties based on the major portion price derived by the MMS. In May 2007, rather than file a direct appeal of the Administrative Order against BROG, the Jicarilla filed suit solely against the Department of Interior in the United States District Court for the District of Columbia in an action entitled 1:07-CV-00803-RJL, Jicarilla Apache Nation v. Department of Interior (the DOI Case). In the DOI Case, the Jicarilla seek a

**SAN JUAN BASIN ROYALTY TRUST**

**NOTES TO CONDENSED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

declaration that the Administrative Order is unlawful and of no force and effect, as well as an injunction requiring enforcement of the underlying major portion orders that were rejected by the Assistant Secretary. On March 31, 2009, a summary judgment was entered by the district court in the DOI Case upholding the Administrative Order and dismissing the Jicarilla's claims. The Jicarilla appealed to the U.S. Court of Appeals for the D.C. Circuit. On July 16, 2010, the U.S. Court of Appeals held that the 2007 Administrative Order dismissing the Jicarilla claims was arbitrary and capricious with respect to January 1984 through February 1988 production periods and ordered that the matter be remanded back to the Department of Interior for further proceedings. While a judgment or settlement in the DOI Case could impact the Royalty income of the Trust, the Trust has not, at this time, received any report from BROG as to the final disposition of the DOI Case, or any estimate of the amount of any potential loss or the portion of any such potential loss that might be allocated to the Royalty.

In May 2011, a verdict was entered in the case styled Abraham et al. v. BP America Production Company, Case No. 6:09-cv-00961, in the U.S. District Court for the District of New Mexico, awarding the plaintiffs approximately \$9.74 million in damages and \$3.5 million in pre-judgment interest and costs based upon a jury finding that the defendant had failed to pay royalties consistent with market value for gas produced in the San Juan Basin. The defendant appealed to the Tenth Circuit. Plaintiffs have filed a cross-appeal on several grounds, including that the trial court should have submitted the punitive damage issue to the jury. Briefing should commence in 30-60 days. The Trust is a member of the plaintiff class. If there is ultimately a distribution to the plaintiff class, it is uncertain whether any amount distributed to the Trust will be material. The Trustee will continue to monitor these proceedings.

During the second quarter of 2011, \$681,548 was included in calculating net proceeds paid to the Trust as a result of the ongoing compliance audit process.

**Item 2. *Trustee's Discussion and Analysis of Financial Condition and Results of Operations.***

**Forward-Looking Information**

Certain information included in this Quarterly Report on Form 10-Q contains, and other materials filed or to be filed by the Trust with the Securities and Exchange Commission (as well as information included in oral statements or other written statements made or to be made by the Trust) may contain or include, forward-looking statements. Such forward-looking statements may be or may concern, among other things, capital expenditures, drilling activity, development activities, production efforts and volumes, hydrocarbon prices, estimated future net revenues, estimates of reserves, the results of the Trust's activities, and regulatory matters. Such forward-looking statements generally are accompanied by words such as may, will, estimate, expect, predict, project, anticipate, goal, should, plan, intend, or other words that convey the uncertainty of future events or outcomes. Such statements reflect the current view of Burlington Resources Oil & Gas Company LP (BROG), the working interest owner, with respect to future events; are based on an assessment of, and are subject to, a variety of factors deemed relevant by the Trustee and BROG; and involve risks and uncertainties. These risks and uncertainties include volatility of oil and gas prices, product supply and demand, competition, regulation or government action, litigation and uncertainties about estimates of reserves. Should one or more of these risks or uncertainties occur, actual results may vary materially and adversely from those anticipated.

**Business Overview**

The Trust is an express trust created under the laws of the state of Texas by the San Juan Basin Royalty Trust Indenture (the Original Indenture) entered into on November 3, 1980 between Southland Royalty Company (Southland Royalty) and The Fort Worth National Bank. Effective as of September 30, 2002, the Original Indenture was amended and restated (the Original Indenture, as amended and restated, the First Restated Indenture) and, effective as of December 12, 2007 the First Restated Indenture was amended and restated (the First Restated Indenture, as amended and restated, the Indenture). The Trustee of the Trust is Compass Bank.

On October 23, 1980, the stockholders of Southland Royalty approved and authorized that company's conveyance of a 75% net overriding royalty interest (equivalent to a net profits interest) to the Trust for the benefit of the stockholders of Southland Royalty of record at the close of business on the date of the conveyance (the Royalty) carved out of that company's oil and gas leasehold and royalty interests (the Underlying Properties) in properties located in the San Juan Basin of northwestern New Mexico. Pursuant to the Net Overriding Royalty Conveyance (the Conveyance) the Royalty was transferred to the Trust on November 3, 1980 effective as to production from and after November 1, 1980.

The Royalty constitutes the principal asset of the Trust. The beneficial interests in the Royalty are divided into that number of Units of Beneficial Interest (the Units) of the Trust equal to the number of shares of the common stock of Southland Royalty outstanding as of the close of business on November 3, 1980. Each stockholder of Southland Royalty of record at the close of business on November 3, 1980 received one freely tradable Unit for each share of the common stock of Southland Royalty then held. Holders of Units are referred to herein as Unit Holders. Subsequent to the Conveyance of the Royalty, through a series of assignments and mergers, Southland Royalty's successor became BROG. On March 31, 2006, a subsidiary of ConocoPhillips completed its acquisition of Burlington Resources, Inc., BROG's parent. As a result, ConocoPhillips became the parent of Burlington Resources, Inc., which in turn, is the parent of BROG. On July 14, 2011, ConocoPhillips announced that its board of directors approved the separation of the company's refining and marketing business from its exploration and production business. According to ConocoPhillips, both businesses will be stand-alone, publicly traded corporations after the separation, which ConocoPhillips expects to complete by the first half of 2012. The Trustee will continue to monitor this situation's

effect on the Trust, if any.

The function of the Trustee is to collect the net proceeds attributable to the Royalty ( Royalty Income ), to pay all expenses and charges of the Trust and distribute the remaining available income to the Unit Holders. The Trust does not operate the Underlying Properties and, in fact, is not empowered to carry on any business activity. The Trust has no employees, officers or directors. All administrative functions of the Trust are performed by the Trustee.

BROG is the principal operator of the Underlying Properties. A very high percentage of the Royalty Income is attributable to the production and sale by BROG of natural gas from the Underlying Properties. Accordingly, the market price for natural gas produced and sold from the San Juan Basin heavily influences the amount of Royalty Income distributed by the Trust and, by extension, the price of the Units.

**Three Months Ended June 30, 2011 and 2010**

The Trust received Royalty income of \$15,568,211 and interest income of \$683,060 during the second quarter of 2011. There was no change in cash reserves. After deducting administrative expenses of \$526,817, distributable income for the quarter was \$15,724,454 (\$0.337370 per Unit). In the second quarter of 2010, Royalty income was \$22,450,139, interest income was \$4,776, administrative expenses were \$774,334 and distributable income was \$21,680,581 (\$0.465161 per Unit). Based on 46,608,796 Units outstanding, the per-Unit distributions during the second quarter of 2011 were as follows:

April	\$ .082643
May	.131171
June	.123556
 Quarter Total	 \$ .337370

The Royalty income distributed in the second quarter of 2011 was lower than that distributed in the second quarter of 2010, primarily due to a decrease in the average gas price from \$5.12 per Mcf for the second quarter of 2010 to \$4.81 per Mcf for the second quarter of 2011. Interest income was higher for the quarter ended June 30, 2011 as compared to the quarter ended June 30, 2010, due to additional interest from granted audit exceptions received in May 2011. Administrative expenses were lower in 2011 primarily as a result of decreased costs associated with litigation that was settled in April of 2010.

The capital costs attributable to the Underlying Properties for the second quarter of 2011 and deducted by BROG in calculating Royalty income were approximately \$5.6 million as compared to approximately \$2.2 million of capital costs in the second quarter of 2010. BROG has informed the Trust that its budget for capital expenditures for the Underlying Properties in 2011 is estimated at \$13.6 million. Of the \$13.6 million, approximately \$3.25 million will be attributable to the capital budgets for 2010 and prior years. BROG reports that based on its actual capital requirements, the pace of regulatory approvals, the mix of projects and swings in the price of natural gas, the actual capital expenditures for 2011 could range from \$5 million to \$35 million.

BROG anticipates 417 projects in 2011. Approximately \$8.3 million of the \$13.6 million budget is allocable to 38 new wells, including 33 wells scheduled to be dually completed in the Mesaverde and Dakota formations. BROG indicates that five of the new wells are projected to be drilled to Fruitland Coal, Fruitland Sand or Pictured Cliffs formations. Approximately \$2 million will be spent on workovers and facilities projects. Of the \$3.25 million attributable to the budgets for prior years, approximately \$2.45 million is allocable to new wells and the \$800,000 balance will be applied to miscellaneous capital projects such as workovers and operated facility projects. Although the estimated project count for new wells is slightly lower for 2011 as compared to 2010, BROG points out that the Trust's interest in those properties to be developed is higher than those drilled last year.

BROG has informed the Trust that lease operating expenses and property taxes were \$8,498,642 and \$150,406, respectively, for the second quarter of 2011, as compared to \$7,842,642 and \$270,213, respectively, for the second quarter of 2010. BROG indicates the increase in operating expenses in the second quarter 2011 is due to pressure on

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costs as BROG competes for contract labor and services with other developments in the lower 48 states. Those costs are reflected in the second quarter distributions.

BROG has reported to the Trustee that during the second quarter of 2011, 13 gross (2.94 net) conventional wells and one gross (0.32 net) coal seam well were completed on the Underlying Properties. Eighteen gross (3.48 net) conventional wells were in progress at June 30, 2011.

There were nine gross (1.50 net) conventional wells completed on the Underlying Properties during the second quarter of 2010. Nineteen gross (2.22 net) conventional wells were in progress at June 30, 2010.

There were 4,016 gross (1,173 net) producing wells being operated subject to the Royalty as of December 31, 2010, calculated on a well bore basis and not including multiple completions as separate wells.

*Gross* acres or wells, for purposes of this discussion, means the entire ownership interest of all parties in such properties, and BROG's interest therein is referred to as the net acres or wells. A payadd is the completion of an additional productive interval in an existing completed zone in a well.

Royalty income for the quarter ended June 30, 2011 is associated with actual gas and oil production during February 2011 through April 2011 from the Underlying Properties. Gas and oil sales from the Underlying Properties for the three months ended June 30, 2011 and 2010 were as follows:

	<b>Three Months Ended June 30,</b>	
	<b>2011</b>	<b>2010</b>
Gas:		
Total sales (Mcf)	7,724,467	7,710,876
Mcf per day	86,792	86,639
Average price (per Mcf)	\$ 4.81	\$ 5.12
Oil:		
Total sales (Bbls)	15,323	14,701
Bbls per day	172	165
Average price (per Bbl)	\$ 91.18	\$ 71.54

During the second quarter of 2011, average gas prices were \$0.31 per Mcf lower than the average prices reported during the second quarter of 2010. The average price per barrel of oil during the second quarter of 2011 was \$19.64 per barrel higher than that received for the second quarter of 2010.

BROG previously entered into four contracts effective April 1, 2009, for the sale of all gas produced from the Underlying Properties other than the gas covered by a pre-existing contract with New Mexico Gas Company, Inc. ( NMGC ). The then current purchasers were Chevron Natural Gas, a division of Chevron USA, Inc. ( Chevron ), Pacific Gas and Electric Company ( PG&E ), BP Energy Company, Macquarie Cook Energy LLC, and NMGC. In March 2010, notice of termination of each of the Chevron, BP Energy Company and Macquarie Cook Energy LLC contracts was given such that they terminated effective March 31, 2011. Requests for proposal were circulated to potential purchasers of those packages of gas covered by the expiring contracts with a view toward obtaining new contracts to be effective April 1, 2011. Neither BROG, PG&E, nor NMGC gave notice of termination of their contracts such that the terms of those two contracts have been automatically extended through at least March 31, 2013.

BROG has now entered into three new contracts effective April 1, 2011, for the sale of the gas produced from the Underlying Properties but not sold under the two pre-existing contracts. The purchasers under such new contracts are Chevron, PG&E and Salt River Project Agricultural Improvement and Power District ( SRP ). All five of the current contracts provide for (i) the delivery of such gas at various delivery points through March 31, 2013 and from year-to-year thereafter, until terminated by either party on 12 months notice (except for the SRP contract which terminates March 31, 2012); and (ii) the sale of such gas at prices which fluctuate in accordance with the published indices for gas sold in the San Juan Basin of northwestern New Mexico.

BROG contracts with Williams Four Corners, LLC ( WFC ) and Enterprise Field Services, LLC ( EFS ) for the gathering and processing of virtually all of the gas produced from the Underlying Properties. Four new contracts were

entered into with WFC to be effective for terms of 15 years commencing April 1, 2010. The new contracts consolidated and replaced 18 prior contracts with WFC. BROG indicates that the new contracts provide some modest reductions in fees and also improved services, including more rigorous line pressure controls and the right to install compression facilities as needed.

However, BROG reports that it has been unable to reach agreement with EFS on gathering and processing contracts, and it has joined a group of others in an administrative proceeding before the New Mexico Public Utility Commission, complaining, *inter alia*, that EFS is insisting upon above-market rates and refusing to agree to



essential pressure control services. EFS delivered notice to BROG terminating existing contracts effective December 1, 2010, but on December 10, 2010, an injunction was issued prohibiting EFS from reducing gas flows under the contracts. The dispute was the subject of a mediation conducted in March 2011, which resulted in a tentative agreement for a new gas gathering and processing contract. The contract is still subject to executive management approval and drafting of mutually acceptable documentation. Litigation deadlines, which were initially extended for 90 days, were further extended for 30-60 days to give all the parties time to finalize the language of a definitive contract, the terms of which are still under negotiation. Additionally, both parties are working toward resolving other issues prior to execution of the new agreement, such as historical imbalances and audits. BROG indicates the approval of the new agreement by its management will not be sought until all issues have been resolved. Meanwhile, the parties continue to perform under the preliminary injunction issued by the court. The implementation of the new agreement will likely not impact the Trust until the fourth quarter of 2011. The Trustee will continue to monitor this matter as it may relate to the Trust.

Confidentiality agreements with gatherers and purchasers of gas produced from the Underlying Properties prohibit public disclosure of certain terms and conditions of gas sales contracts with those entities, including specific pricing terms and gas receipt points. Such disclosure could compromise the ability to compete effectively in the marketplace for the sale of gas produced from the Underlying Properties.

#### **Six Months Ended June 30, 2011 and 2010**

For the six months ended June 30, 2011, the Trust received Royalty income of \$30,957,341 and interest income of \$684,525. There was no change in cash reserves. After deducting administrative expenses of \$1,048,502, distributable income was \$30,593,364 (\$0.656385 per Unit) for the six months ended June 30, 2011. For the six months ended June 30, 2010, the Trust received Royalty income of \$44,452,655 and interest income of \$213,089. There was no change in cash reserves. After deducting administrative expenses of \$1,455,845, distributable income was \$43,209,899 (\$0.927076 per Unit) for the six months ended June 30, 2010.

The decrease in distributable income from 2010 to 2011 resulted primarily from lower gas prices and higher capital expenditures during the first half of 2011 and the receipt of \$2,600,000 in 2010 in settlement of the legal proceedings described in Part II, Item 1. Interest earnings for the six months ended June 30, 2011, as compared to the six months ended June 30, 2010 were higher due to the receipt of \$681,548 in interest due on the late payment of net proceeds as a result of the ongoing negotiation of compliance audit issues. General and administrative expenses were lower for the six months ended June 30, 2011, as compared to the same period in 2010 primarily as a result of differences in timing in the receipt and payment of the expenses and also as a result of decreased costs associated with litigation that was settled in April of 2010.

Capital expenditures incurred by BROG, attributable to the Underlying Properties, for the first six months of 2011 amounted to approximately \$9.3 million. Capital expenditures were approximately \$5.7 million for the first six months of 2010. Lease operating expenses and property taxes totaled \$17,210,683 and \$420,619, respectively, as compared to \$15,642,446 and \$483,502, respectively, for the first six months of 2010.

BROG has reported to the Trustee that during the six months ended June 30, 2011, 28 gross (5.03 net) conventional wells and four gross (0.82 net) coal seam wells were completed on the Underlying Properties. There were 24 gross (5.43 net) conventional wells completed on the Underlying Properties in the six months ending June 30, 2010.

Royalty income for the six months ended June 30, 2011 is associated with actual gas and oil production during November 2010 through April 2011 from the Underlying Properties. Gas and oil sales from the Underlying Properties for the six months ended June 30, 2011 and 2010 were as follows:

	<b>Six Months Ended June 30,</b>	
	<b>2011</b>	<b>2010</b>
Gas:		
Total sales (Mcf)	15,823,372	16,239,746
Mcf per day	87,422	89,722
Average price (per Mcf)	\$ 4.60	\$ 5.14
Oil:		
Total Sales (Bbls)	28,617	27,861
Bbls per day	158	154
Average price (per Bbl)	\$ 82.20	\$ 69.71

#### **Calculation of Royalty Income**

Royalty income received by the Trust for the three months and six months ended June 30, 2011 and 2010, respectively, was computed as shown in the following table:

#### **CALCULATION OF ROYALTY INCOME**

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
<i>Gross proceeds of sales from the Underlying properties:</i>				
Gas proceeds	\$ 37,193,201	\$ 42,960,392	\$ 72,751,172	\$ 86,946,324
Oil proceeds	1,397,093	1,051,752	2,352,417	1,942,221
Total	38,590,294	44,012,144	75,103,589	88,888,545
<i>Less production costs:</i>				
Severance tax gas	3,421,847	3,634,956	6,686,370	7,650,402
Severance tax oil	145,010	97,737	243,461	179,888
Lease operating expense and property tax	8,649,048	8,112,855	17,631,302	16,125,948
Capital expenditures	5,616,774	2,233,077	9,266,002	5,662,100
Total	17,832,679	14,078,625	33,827,135	29,618,338
Net profits	20,757,615	29,933,519	41,276,454	59,270,207
Net overriding royalty interest	75%	75%	75%	75%
<i>Royalty Income</i>	\$ 15,568,211	\$ 22,450,139	\$ 30,957,341	\$ 44,452,655

### **Contractual Obligations**

Under the Indenture governing the Trust, the Trustee is entitled to an administrative fee for its administrative services and the preparation of quarterly and annual statements of: (i) 1/20 of 1% of the first \$100 million of the annual gross revenue of the Trust, and 1/30 of 1% of the annual gross revenue of the Trust in excess of \$100 million and (ii) the Trustee's standard hourly rates for time in excess of 300 hours annually, provided that the administrative fee due under items (i) and (ii) above will not be less than \$36,000 per year (as adjusted annually to reflect the increase (if any) in the Producers Price Index as published by the U.S. Department of Labor, Bureau of Labor Statistics, since December 31, 2003).

## Effects of Securities Regulation

As a publicly-traded trust listed on the New York Stock Exchange (the NYSE), the Trust is and will continue to be subject to extensive regulation under, among others, the Securities Act of 1933, the Securities Exchange Act of 1934 (which contains many of the provisions of the Sarbanes-Oxley Act of 2002), and the rules and regulations of the NYSE. Issuers failing to comply with such authorities risk serious consequences, including criminal as well as civil and administrative penalties. In most instances, these laws, rules, and regulations do not specifically address their applicability to publicly-traded trusts, such as the Trust. In particular, the Sarbanes-Oxley Act of 2002 provides for the adoption by the Securities and Exchange Commission (the Commission) and NYSE of certain rules and regulations that may be impossible for the Trust to literally satisfy because of its nature as a pass-through trust. It is the Trustee's intention to follow the Commission's and NYSE's rulemaking closely, attempt to comply with such rules and regulations and, where appropriate, request relief from these rules and regulations. However, if the Trust is unable to comply with such rules and regulations or to obtain appropriate relief, the Trust may be required to expend presently unknown but potentially material costs to amend the Indenture that governs the Trust to allow for compliance with such rules and regulations. To date, the rules implementing the Sarbanes-Oxley Act of 2002 have generally made appropriate accommodation for passive entities such as the Trust.

## Critical Accounting Policies

In accordance with the Commission's rules and regulations and consistent with other royalty trusts, the financial statements of the Trust are prepared on the following basis:

Royalty Income recorded for a month is the amount computed and paid pursuant to the Conveyance by BROG to the Trustee for the Trust. Royalty Income consists of the proceeds received by BROG from the sale of production from the Underlying Properties less accrued production costs, development and drilling costs, applicable taxes, operating charges, and other costs and deductions, multiplied by 75%. The calculation of net proceeds by BROG for any month includes adjustments to proceeds and costs for prior months and impacts the Royalty Income paid to the Trust and the distribution to Unit Holders for that month.

Trust expenses recorded are based on liabilities paid and cash reserves established from Royalty Income for liabilities and contingencies.

Distributions to Unit Holders are recorded when declared by the Trustee.

The Conveyance which transferred the Royalty to the Trust provides that any excess of development and production costs applicable to the Underlying Properties over gross proceeds from such properties must be recovered from future net proceeds before Royalty Income is again paid to the Trust.

The financial statements of the Trust differ from financial statements prepared in accordance with GAAP because revenues are not accrued in the month of production; certain cash reserves may be established for contingencies which would not be accrued in financial statements prepared in accordance with GAAP; expenses are recorded when paid instead of when incurred; and amortization of the Royalty calculated on a unit-of-production basis is charged directly to the Trust corpus instead of as an expense.

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

The Trust invests in no derivative financial instruments, and has no foreign operations or long-term debt instruments. The Trust is a passive entity and is prohibited from engaging in a trade or business, including borrowing transactions, other than as periodically necessary to pay expenses, liabilities and obligations of the Trust that cannot be paid out of

cash held by the Trust. The amount of any such borrowings is unlikely to be material to the Trust. The Trust is also permitted to hold short-term investments acquired with funds held by the Trust pending distribution to Unit Holders and funds held in reserve for the payment of Trust expenses and liabilities. Because of the short-term nature of these borrowings and investments and certain limitations upon the types of such investments which may be held by the Trust, the Trustee believes that the Trust is not subject to any material interest rate risk. The Trust is not permitted to engage in transactions in foreign currencies which could expose the Trust or Unit Holders to any foreign currency related market risk. The Trust is not permitted to market the gas, oil or natural gas liquids from the Underlying Properties; BROG is responsible for such marketing.

**Item 4. *Controls and Procedures.***

The Trust maintains a system of disclosure controls and procedures that is designed to ensure that information required to be disclosed in the Trust's filings under the Securities Exchange Act of 1934 is recorded, processed, summarized, and reported within the time periods specified in the Commission's rules and forms. Due to the pass-through nature of the Trust, BROG provides much of the information disclosed in this Form 10-Q and the other periodic reports filed by the Trust with the Commission. Consequently, the Trust's ability to timely disclose relevant information in its periodic reports is dependent upon BROG's delivery of such information. Accordingly, the Trust maintains disclosure controls and procedures designed to ensure that BROG accurately and timely accumulates and delivers such relevant information to the Trustee and those who participate in the preparation of the Trust's periodic reports to allow for the preparation of such periodic reports and any decisions regarding disclosure.

The Indenture does not require BROG to update or provide information to the Trust. However, the Conveyance transferring the Royalty to the Trust obligates BROG to provide the Trust with certain information, including information concerning calculations of net proceeds owed to the Trust. Pursuant to the settlement of litigation in 1996 between the Trust and BROG, BROG agreed to newer, more formal financial reporting and audit procedures as compared to those provided in the Conveyance.

In order to help ensure the accuracy and completeness of the information required to be disclosed in the Trust's periodic reports, the Trust employs independent public accountants, compliance auditors, marketing consultants, attorneys and petroleum engineers. These outside professionals advise the Trustee in its review and compilation of this information for inclusion in this Form 10-Q and the other periodic reports provided by the Trust to the Commission.

The Trustee has evaluated the Trust's disclosure controls and procedures as of June 30, 2011 and has concluded that such disclosure controls and procedures are effective, at the reasonable assurance level, to ensure that material information related to the Trust is gathered on a timely basis to be included in the Trust's periodic reports and recorded, processed, summarized and reported within the time periods specified in the Commission's rules and forms. In reaching its conclusion, the Trustee has considered the Trust's dependence on BROG to deliver timely and accurate information to the Trust. Additionally, during the quarter ended June 30, 2011 there were no changes in the Trust's internal control over financial reporting that materially affected, or are reasonably likely to materially affect, the Trust's internal control over financial reporting. The Trustee has reviewed neither the Trust's disclosure controls and procedures nor the Trust's internal control over financial reporting in concert with management, a board of directors or an independent audit committee. The Trust does not have, nor does the Indenture provide for, officers, a board of directors or an independent audit committee.

**PART II**

**OTHER INFORMATION**

**Item 1. *Legal Proceedings.***

As discussed above under Part I, Item 4 – Controls and Procedures, due to the pass-through nature of the Trust, BROG provides much of the information disclosed in this Form 10-Q and the other periodic reports filed by the Trust with the Commission. Although the Trustee receives periodic updates from BROG regarding activities which may relate to the Trust, the Trust's ability to timely report certain information required to be disclosed in the Trust's periodic reports is dependent on BROG's timely delivery of the information to the Trust.

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On March 14, 2008, BROG notified the Trust that the distribution for March would be reduced by \$4,921,578. BROG described this amount as the Trust's portion of what BROG had paid to settle claims for the underpayment of royalties in the case styled United States of America ex rel. Harrold E. ( Gene ) Wright v. AGIP Petroleum Co. et al., Civil Action No. 5:03CV264 (formerly 9:98-CV-30) (E.D. Tex.). The Trust's consultants continue to analyze this settlement as it may apply to the Trust.

Following mediation conducted on April 8 and 23, 2010, BROG and the Trust entered into a settlement of previously reported litigation styled San Juan Basin Royalty Trust vs. Burlington Resources Oil & Gas Company, L.P.,

No. D1329-CV-08-751, in the District Court of Sandoval County, New Mexico, 13th Judicial District. The dispute subject to the mediation arose out of an arbitrator's award in 2005 in favor of the Trust. That award effectively resolved five compliance audit issues, but BROG argued in subsequent litigation that one of those issues was beyond the scope of the matters agreed to be submitted to arbitration. Pursuant to the settlement, the litigation was dismissed, BROG paid \$2,600,000 to the Trust in May 2010, and released its claims for attorneys' fees.

BROG has informed the Trust that pursuant to an Order to Perform (the "MMS Order") issued by the Minerals Management Service ("MMS") dated June 10, 1998, the Jicarilla Apache Nation (the "Jicarilla") alleged that in valuing production for royalty purposes one must perform (i) a major portion analysis, which calculates value on the highest price paid or offered for a major portion of the gas produced from the field where the leased lands are situated; and (ii) a dual accounting calculation, which computes royalties on the greater of (a) the value of gas prior to processing or (b) the combined value of processed residue gas and plant products plus the value of any condensate recovered downstream without processing. The MMS Order alleged that BROG's dual accounting calculations on Native American leases were based on less than major portion prices. In December 2000, BROG and the Jicarilla entered into a settlement agreement resolving the issues associated with the dual accounting calculation. The major portion calculation issue remains outstanding. BROG takes the position that a judgment or settlement could entitle BROG to reimbursement from the Trust for past periods.

According to BROG, on March 28, 2007 the Assistant Secretary of Indian Affairs of the United States Department of Interior issued an administrative order in BROG's appeal of the major portion calculation issue of the MMS Order entitled MMS-98-0141-IND Burlington Resources Oil & Gas Company LP (the "Administrative Order"). The Administrative Order rejected that portion of the MMS Order requiring BROG to calculate and pay additional royalties based on the major portion price derived by the MMS. In May 2007, rather than file a direct appeal of the Administrative Order against BROG, the Jicarilla filed suit solely against the Department of Interior in the United States District Court for the District of Columbia in an action entitled 1:07-CV-00803-RJL, Jicarilla Apache Nation v. Department of Interior (the "DOI Case"). In the DOI Case, the Jicarilla seek a declaration that the Administrative Order is unlawful and of no force and effect, as well as an injunction requiring enforcement of the underlying major portion orders that were rejected by the Assistant Secretary. On March 31, 2009, a summary judgment was entered by the district court in the DOI Case upholding the Administrative Order and dismissing the Jicarilla's claims. The Jicarilla appealed to the U.S. Court of Appeals for the D.C. Circuit. On July 16, 2010, the U.S. Court of Appeals held that the 2007 Administrative Order dismissing the Jicarilla claims was arbitrary and capricious with respect to January 1984 through February 1988 production periods and ordered that the matter be remanded back to the Department of Interior for further proceedings. While a judgment or settlement in the DOI Case could impact the Royalty income of the Trust, the Trust has not, at this time, received any report from BROG as to the final disposition of the DOI Case, or any estimate of the amount of any potential loss or the portion of any such potential loss that might be allocated to the Royalty.

In May 2011, a verdict was entered in the case styled Abraham et al. v. BP America Production Company, Case No. 6:09-cv-00961, in the U.S. District Court for the District of New Mexico, awarding the plaintiffs approximately \$9.74 million in damages and \$3.5 million in pre-judgment interest and costs based upon a jury finding that the defendant had failed to pay royalties consistent with market value for gas produced in the San Juan Basin. The defendant appealed to the Tenth Circuit. Plaintiffs have filed a cross-appeal on several grounds, including that the trial court should have submitted the punitive damage issue to the jury. Briefing should commence in 30-60 days. The Trust is a member of the plaintiff class. If there is ultimately a distribution to the plaintiff class, it is uncertain whether any amount distributed to the Trust will be material. The Trustee will continue to monitor these proceedings.



**Item 6. Exhibits.**

- (4)(a) Amended and Restated Royalty Trust Indenture, dated September 30, 2002 (the original Royalty Trust Indenture, dated November 1, 1980, having been entered into between Southland Royalty Company and The Fort Worth National Bank, as Trustee), heretofore filed as Exhibit 99.2 to the Trust's Current Report on Form 8-K filed with the Commission on October 1, 2002, is incorporated herein by reference.\*
- (4)(b) Net Overriding Royalty Conveyance from Southland Royalty Company to The Fort Worth National Bank, as Trustee, dated November 3, 1980 (without Schedules), heretofore filed as Exhibit 4(b) to the Trust's Annual Report on Form 10-K filed with the Commission for the fiscal year ended December 31, 2007, is incorporated herein by reference.\*
- (4)(c) Assignment of Net Overriding Interest (San Juan Basin Royalty Trust), dated September 30, 2002, between Bank One, N.A. and TexasBank, heretofore filed as Exhibit 4(c) to the Trust's Quarterly Report on Form 10-Q filed with the Commission for the quarter ended September 30, 2002, is incorporated herein by reference.\*
- 31 Certification required by Rule 13a-14(a), dated August 9, 2011, by Lee Ann Anderson, Vice President and Senior Trust Officer of Compass Bank, the Trustee of the Trust.\*\*
- 32 Certification required by Rule 13a-14(b), dated August 9, 2011, by Lee Ann Anderson, Vice President and Senior Trust Officer of Compass Bank, on behalf of Compass Bank, the Trustee of the Trust.\*\*\*

\* A copy of this exhibit is available to any Unit Holder (free of charge) upon written request to the Trustee, Compass Bank, 2525 Ridgmar Boulevard, Suite 100, Fort Worth, Texas 76116.

\*\* Filed herewith.

\*\*\* Furnished herewith.

**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.

COMPASS BANK, AS TRUSTEE OF THE SAN JUAN BASIN ROYALTY TRUST

By: /s/ Lee Ann Anderson

Lee Ann Anderson  
Vice President and Senior Trust Officer

Date: August 9, 2011

(The Trust has no directors or executive officers.)

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**INDEX TO EXHIBITS**

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