

SAN JUAN BASIN ROYALTY TRUST  
Form 10-Q  
November 10, 2014

**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 September 30, 2014**

**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**

**300 W. 7<sup>th</sup> Street, Suite B**

**Fort Worth, Texas 76102**

**(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

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, or a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

Number of Units of beneficial interest outstanding at November 10, 2014: 46,608,796



**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, 2013. 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 September 30, 2014 and the distributable income and changes in trust corpus for the three-month and nine-month periods ended September 30, 2014 and 2013. The distributable income for such interim periods is not necessarily indicative of the distributable income for the full year.

## CONDENSED STATEMENTS OF ASSETS, LIABILITIES AND TRUST CORPUS

	<i>September 30, 2014 (Unaudited)</i>	<i>December 31, 2013</i>
<b>ASSETS</b>		
Cash and short-term investments	\$ 5,504,178	\$ 4,650,682
Net overriding royalty interest in producing oil and gas properties (net of accumulated amortization of \$123,538,063 and \$122,306,532 at September 30, 2014 and December 31, 2013, respectively)	9,737,465	10,968,996
	\$ 15,241,643	\$ 15,619,678
<b>LIABILITIES AND TRUST CORPUS</b>		
Distribution payable to Unit Holders	\$ 5,317,936	\$ 4,464,440
Cash reserves	186,242	186,242
Trust corpus 46,608,796 Units of beneficial interest authorized and outstanding	9,737,465	10,968,996
	\$ 15,241,643	\$ 15,619,678

## CONDENSED STATEMENTS OF DISTRIBUTABLE INCOME (UNAUDITED)

	<i>Three Months Ended September 30,</i>		<i>Nine Months Ended September 30,</i>	
	2014	2013	2014	2013
Royalty income	\$ 16,076,429	\$ 13,743,934	\$ 48,726,954	\$ 23,653,832
Interest income	1,900	1,240	74,067 <sup>(1)</sup>	1,904
Total revenue	16,078,329	13,745,174	48,801,021	23,655,736
General and administrative expenditures	385,623	288,883	1,306,212	1,236,950
Increase in cash reserves				29,518
Distributable income	\$ 15,692,706	\$ 13,456,291	\$ 47,494,809	\$ 22,389,268
Distributable income per Unit (46,608,796 Units)	\$ 0.336690	\$ 0.288708	\$ 1.019009	\$ 0.480366

(1) Includes \$69,241 interest on the late payment of gross proceeds as a result of the ongoing negotiation of compliance audit issues.

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

	<i>Three Months Ended September 30,</i>		<i>Nine Months Ended September 30,</i>	
	2014	2013	2014	2013
Trust corpus, beginning of period	\$ 10,164,223	\$ 11,847,943	\$ 10,968,996	\$ 12,163,460

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Amortization of net overriding royalty interest	(426,758)	(469,863)	(1,231,531)	(785,380)
Distributable income	15,692,706	13,456,291	47,494,809	22,389,268
Distributions declared	(15,692,706)	(13,456,291)	(47,494,809)	(22,389,268)
Trust corpus, end of period	\$ 9,737,465	\$ 11,378,080	\$ 9,737,465	\$ 11,378,080

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

**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:

The net proceeds attributable to the Royalty (the 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 (Burlington), the present owner of the Underlying Properties, to Compass Bank (the Trustee) as the Trustee for the Trust. Royalty Income consists of the proceeds received by Burlington 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 Burlington 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 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 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. 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.

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.

**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.**

### 3. CONTINGENCIES

In February 2014 Burlington informed the Trustee it had discovered a failure by Burlington to properly allocate approximately \$4.3 million of severance taxes to the calculation of the Royalty during a period commencing in 2007 until the allocation was corrected in 2012, which resulted in what it characterized as an overpayment to the Trust in the amount of approximately \$3.25 million. Burlington proposed and has begun to recoup the overpayment in installments of \$361,215 commencing in March 2014 and continuing in equal installments through November 2014. Burlington has elected not to charge interest on the overpayment, although it has reserved the right to do so. The Trust and its advisors are analyzing the facts and circumstances and will continue communication with Burlington on this claim.

### 4. SETTLEMENTS AND LITIGATION

On July 31, 2014, the Trustee filed a lawsuit against Burlington in the 1<sup>st</sup> Judicial District Court for the County of Santa Fe, State of New Mexico (the 2014 Litigation). The case is styled Compass Bank, in its Capacity as Trustee of the San Juan Basin Royalty Trust v. Burlington Resources Oil & Gas Company LP and BROG GP LLC, No. D-101-CV-2014-01765. The Trust asserts claims for breach of contract and breach of the implied covenant of good faith and fair dealing, and seeks a declaratory judgment arising out of a number of unresolved revenue and expense audit exceptions asserted by the Trust's auditors. More particularly, the claims involve Burlington's failure to properly account for and pay net overriding royalty interests to the Trust with respect to oil and gas production from numerous properties in the San Juan Basin of northwestern New Mexico. Based on information currently available to the Trust and its auditors, the Trust seeks monetary relief (including actual and punitive damages, costs, expenses, interest and attorney fees) in excess of \$12,000,000, along with specific performance of certain contractual obligations, declaratory relief and a judgment for other relief to which it may show itself to be justly entitled. Burlington has filed an answer and the parties have commenced discovery, which is in its early stages.

On March 14, 2008, Burlington notified the Trust that the distribution for March would be reduced by \$4,921,578. Burlington described this amount as the Trust's portion of what Burlington 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 has objected to Burlington's unilateral decision to deduct any amount of the settlement paid by Burlington from the distributions payable to the Trust and formally complained of that action as part of the 2014 Litigation. The Trust argues that no part of the settlement should have been allocated to the Trust because the claim which gave rise to the settlement was presented to Burlington for payment prior to the effective date of a mutual release of all claims entered into by Burlington and the Trust in 1996. In the alternative, the Trust contends that even if Burlington's allocation of part of the Wright settlement was not barred by the mutual release, the amount allocated to the Trust by Burlington was improper and excessive.

Burlington has informed the Trust that pursuant to an Order to Perform issued by the Minerals Management Service (MMS) dated June 10, 1998 (the MMS Order), 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 Burlington's dual accounting calculations on Native American leases were based on less than major portion prices. In 2000, Burlington and the Jicarilla entered into a settlement agreement resolving the issues associated with the dual accounting calculation. The major portion calculation issue remains outstanding. Burlington takes the position that a judgment or settlement could entitle Burlington to reimbursement from the Trust for past periods.

In 2007 Burlington obtained an Administrative Order from the Department of the Interior (the "DOI") rejecting that portion of the MMS Order requiring Burlington to calculate and pay additional royalties based on the major portion price derived by the MMS. The Jicarilla filed suit solely against the DOI 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") seeking 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. In 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 by Memorandum Order dated October 7, 2011, remanded the matter to the DOI for further proceedings. While a judgment or settlement in the DOI Case could impact the Royalty Income of the Trust, Burlington has informed the Trust that it does not have sufficient information to estimate a range of loss for the Trust because the DOI has not provided a major portion calculation for the January 1984 to February 1988 time period as required by the July 16, 2010 Court of Appeals ruling described above. Burlington indicates that the situation will not be alleviated until the DOI provides Burlington with a new Order to Perform or similar notice, but that it cannot predict when or if the DOI will provide such information or notice. The Trust's consultants will continue to monitor development in this matter and analyze the appropriateness of the allocation, if any, by Burlington of any portion of any settlement or judgment in calculating the Royalty.

## **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 ( "Burlington"), 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 Burlington; 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 Burlington. In March 2006, a subsidiary of ConocoPhillips completed its acquisition of Burlington Resources, Inc., Burlington's parent. As a result, ConocoPhillips became the parent of Burlington Resources, Inc., which in turn, is the parent of Burlington.

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.

Burlington is the principal operator of the Underlying Properties. A very high percentage of the Royalty Income is attributable to the production and sale by Burlington 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 September 30, 2014 and 2013

The Trust received Royalty Income of \$16,076,429 and interest income of \$1,900 during the third quarter of 2014. After deducting administrative expenses of \$385,623, distributable income for the quarter was \$15,692,706 (\$0.336690 per Unit). In the third quarter of 2013, Royalty Income was \$13,743,934, and interest income was \$1,240. After deducting administrative expenses of \$288,883, distributable income for the third quarter of 2013 was \$13,456,291 (\$0.288708 per Unit). Based on 46,608,796 Units outstanding, the per-Unit distributions during the third quarter of 2014 were as follows:

July	\$ .117918
August	.104675
September	.114097
Quarter Total	\$ .336690

The Royalty Income distributed in the third quarter of 2014 was higher than that distributed in the third quarter of 2013 primarily due to decreased capital expenditures and lease operating expense, as well as an increase in the average gas price from \$3.64 per Mcf for the third quarter of 2013 to \$4.47 for the third quarter of 2014. Interest income was higher for the quarter ended September 30, 2014 as compared to the quarter ended September 30, 2013 primarily due to an increase in funds available for investment. Administrative expenses were higher in 2014 primarily as a result of increased legal costs incurred in the 2014 Litigation and differences in timing in the receipt and payment of certain of these expenses.

In February 2014, Burlington informed the Trustee it had discovered a failure by Burlington to properly allocate approximately \$4.3 million of severance taxes to the calculation of the Royalty during a period commencing in 2007 until the allocation was corrected in 2012, which resulted in what it characterized as an overpayment to the Trust in the amount of approximately \$3.25 million. Burlington proposed and has begun to recoup the overpayment in installments of \$361,215 starting in March 2014 and continuing in equal installments through November 2014. Burlington has elected not to charge interest against the overpayment, although it has reserved the right to do so. The Trust and its advisors are analyzing the facts and circumstances and will continue communication with Burlington on this claim.

The capital costs attributable to the Underlying Properties for the third quarter of 2014 and deducted by Burlington in calculating Royalty Income were approximately \$1.2 million as compared to approximately \$1.6 million of capital costs in the third quarter of 2013.

In January 2014, Burlington informed the Trust that its budget for capital expenditures for the Underlying Properties in 2014 was estimated at \$4.8 million. Burlington reported 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 2014 could range from \$2 million to \$15 million. In light of the challenged price environment for natural gas and natural gas liquids, in March 2013, Burlington announced the temporary suspension of its drilling program in the San Juan Basin. However, Burlington has recently informed the Trust of its plans to commence drilling four new wells by the end of 2014.

Burlington initially anticipated 100 projects in 2014. Approximately \$1.8 million of the original \$4.8 million budget is to be spent on 40 miscellaneous facilities projects. The \$3 million balance is attributable to the budgets for prior years; \$1 million is allocable to 20 new wells commenced prior to 2014 and the \$2 million balance will be applied to miscellaneous capital projects such as workovers and operated facility projects. Now, the four new wells to be commenced in 2014 are estimated to increase that original budget by approximately \$4.7 million for an aggregate of approximately \$9.5 million.

Lease operating expenses and property taxes were \$8,304,363 and \$139,893, respectively, for the third quarter of 2014, as compared to \$9,946,510 and \$168,858, respectively, for the third quarter of 2013. Burlington indicates the decrease in operating expenses in the third quarter of 2014 is primarily due to reductions in contract maintenance and repair labor. Property taxes for the third quarter of 2014 were lower because of a reduction in the accrual based on a new estimate of ad valorem taxes for 2014.

Burlington has reported to the Trustee that during the third quarter of 2014, no conventional wells were completed on the Underlying Properties. There were no wells in progress at September 30, 2014.



There was one gross (0.03 net) conventional well completed on the Underlying Properties during the third quarter of 2013. There were no wells in progress at September 30, 2013.

There were 4,007 gross (1,156.70 net) producing wells being operated subject to the Royalty as of December 31, 2013, calculated on a well bore basis and not including multiple completions as separate wells. Of those wells, seven gross (5.00 net) are oil wells and the balance are gas wells. Burlington reports that approximately 852 gross (325.19 net) of the wells are multiple completion wells resulting in a total of 4,859 gross (1,481.89 net) completions.

Gross acres or wells, for purposes of this discussion, means the entire ownership interest of all parties in such properties, and Burlington's interest therein is referred to as the net acres or wells. In calculating the number of net wells, where a well is completed to multiple formations, Burlington indicates it (a) multiplies the working interest for each zone by a fraction equal to one divided by the total number of completions in that well bore, and (b) adds the interests so calculated for each zone to obtain the net ownership interest in that well. A payadd is the completion of an additional productive interval in an existing completed zone in a well.

Royalty Income for the quarter ended September 30, 2014 is associated with actual gas and oil production during May 2014 through July 2014 from the Underlying Properties. Gas and oil sales from the Underlying Properties for the three months ended September 30, 2014 and 2013 were as follows:

	<i>Three Months Ended</i>	
	<i>September 30,</i>	
	2014	2013
<b>Gas:</b>		
Total sales (Mcf)	7,878,793	8,820,946
Mcf per day	85,639	95,880
Average price (per Mcf)	\$ 4.47	\$ 3.64
<b>Oil:</b>		
Total sales (Bbls)	11,877	15,346
Bbls per day	129	167
Average price (per Bbl)	\$ 87.58	\$ 86.48

During the third quarter of 2014, average gas prices were \$0.83 per Mcf higher than the average prices reported during the third quarter of 2013. The average price per barrel of oil during the third quarter of 2014 was \$1.10 per barrel higher than that received for the third quarter of 2013.

Gas produced from the Underlying Properties is processed at one of the following five plants: Chaco, Val Verde, Milagro, Ignacio, and Kutz, all located in the San Juan Basin. All of such gas other than that processed at Kutz is being sold to Chevron USA, Inc. (Chevron) under a contract with Burlington dated April 1, 2011 which provides for the delivery of gas through March 31, 2015 and from year to year thereafter. Neither Burlington nor Chevron exercised their right to terminate the Chevron contract and therefore, its term has been extended through March 31, 2016, and thereafter until terminated by either party upon six months notice to the other.

Gas produced from the Underlying Properties and processed at Kutz was being sold under three separate contracts with EDF Trading North America, LLC (EDF), Shell Energy North America (US), LP (Shell) and New Mexico Gas Company, Inc. (NMGC). The NMGC contract for the sale of certain winter-only supplies of the Kutz gas is for a five-year term expiring March 31, 2017. The contracts effective as of April 1, 2013 with EDF and Shell are set to expire March 31, 2015. Burlington will circulate another round of requests for proposal for the purchase of those volumes through March 31, 2016.



All four of the current contracts provide for (i) the delivery of such gas at various delivery points through their respective termination dates; 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.

Burlington 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, each of which is effective for a term of 15 years, which commenced April 1, 2010. Burlington has signed a similar agreement with EFS which was effective November 1, 2011 for a term of 15 years. Burlington has disclosed to the Trust a summary of that agreement which the Trust has reviewed with its consultants, subject to conditions of confidentiality.

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.

### **Nine Months Ended September 30, 2014 and 2013**

For the nine months ended September 30, 2014 the Trust received Royalty income of \$48,726,954 and interest income of \$74,067. There was no change in cash reserves. After deducting administrative expenses of \$1,306,212, distributable income was \$47,494,809 (\$1.019009 per Unit) for the nine months ended September 30, 2014.

For the nine months ended September 30, 2013, the Trust received Royalty income of \$23,653,832 and interest income of \$1,904. No distributions were made in March or April 2013. In March 2013, production costs exceeded revenues, and there was a \$156,724 decrease in cash reserves as funds were withdrawn to pay administrative expenses. The cash available for distribution in April 2013 was applied first to pay administrative costs and to replenish the reserve maintained by the Trustee for liabilities and contingencies. There was a \$29,518 net increase in cash reserves. After deducting administrative expenses of \$1,236,950 and the cash reserve increase, distributable income was \$22,389,268 (\$0.480366 per Unit) for the nine months ended September 30, 2013.

The increase in distributable income from 2013 to 2014 resulted primarily from decreased capital expenditures and higher average gas prices during the first nine months of 2014. Interest earnings for the nine months ended September 30, 2014, as compared to the nine months ended September 30, 2013 were higher due to the receipt of \$69,241 in interest on the late payment of net proceeds and interest due on granted and paid audit exceptions as a result of the ongoing negotiation of compliance audit issues. General and administrative expenses were higher for the nine months ended September 30, 2014, as compared to the same period in 2013 primarily due to increased legal costs incurred in the 2014 Litigation and as a result of differences in timing in the receipt and payment of the expenses.

Capital expenditures incurred by Burlington, attributable to the Underlying Properties, for the first nine months of 2014 amounted to approximately \$4.4 million. Capital expenditures were approximately \$20.9 million for the first nine months of 2013. Lease operating expenses and property taxes totaled \$26,595,984 and \$362,021, respectively, for the first nine months of 2014 as compared to \$28,776,600 and \$577,613, respectively, for the first nine months of 2013.

Burlington has reported to the Trustee that during the nine months ended September 30, 2014 no conventional wells were completed on the Underlying Properties. There were 18 gross (9.54 net) conventional wells completed on the Underlying Properties in the nine months ending September 30, 2013.



Royalty income for the nine months ended September 30, 2014 is associated with actual gas and oil production during November 2013 through July 2014 from the Underlying Properties. Gas and oil sales from the Underlying Properties for the nine months ended September 30, 2014 and 2013 were as follows:

	<i>Nine Months Ended September 30,</i>	
	2014	2013
<b>Gas:</b>		
Total sales (Mcf)	23,239,754	24,510,954
Mcf per day	85,127	89,784
Average price (per Mcf)	\$ 4.61	\$ 3.57
<b>Oil:</b>		
Total Sales (Bbls)	45,001	42,153
Bbls per day	165	154
Average price (per Bbl)	\$ 85.00	\$ 82.28

Royalty Income received by the Trust for the three months and nine months ended September 30, 2014 and 2013, respectively, was computed as shown in the following table:

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

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
<b>Gross proceeds of sales from the Underlying Properties:</b>				
Gas proceeds	\$ 35,188,742	\$ 32,093,034	\$ 107,029,765	\$ 87,411,806
Oil proceeds	1,040,247	1,327,173	3,825,015	3,468,538
<b>Total</b>	<b>36,228,989</b>	<b>33,420,207</b>	<b>110,854,780</b>	<b>90,880,344</b>
<b>Less production costs:</b>				
Severance tax gas	5,005,538	3,211,029	14,157,644	8,700,422
Severance tax oil	101,058	142,805	394,928	363,063
Other				4,430 <sup>(2)</sup>
Lease operating expense and property tax	8,444,256	10,115,368	26,958,005	29,354,213
Capital expenditures	1,242,898	1,625,759 <sup>(1)</sup>	4,374,931	20,919,774
<b>Total</b>	<b>14,793,750</b>	<b>15,094,961</b>	<b>45,885,508</b>	<b>59,341,902</b>
<b>Net profits</b>	<b>21,435,239</b>	<b>18,325,246</b>	<b>64,969,272</b>	<b>31,538,442</b>
Net overriding royalty interest	75%	75%	75%	75%
<b>Royalty Income</b>	<b>\$ 16,076,429</b>	<b>\$ 13,743,934</b>	<b>\$ 48,726,954</b>	<b>\$ 23,653,832</b>

- (1) Includes \$387,100 credit due to a downward revision in the capital accrual rate.
- (2) Interest on excess production cost.

### **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 Burlington to the Trustee for the Trust. Royalty Income consists of the proceeds received by Burlington 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 Burlington 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; Burlington 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, Burlington 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 Burlington's delivery of such information. Accordingly, the Trust maintains disclosure controls and procedures designed to ensure that Burlington 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 Burlington to update or provide information to the Trust. However, the Conveyance transferring the Royalty to the Trust obligates Burlington 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 Burlington, Burlington 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 engages 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 September 30, 2014 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 Burlington to deliver timely and accurate information to the Trust. Additionally, during the quarter ended September 30, 2014 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, Burlington 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 Burlington 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 Burlington's timely delivery of the information to the Trust.

On July 31, 2014, the Trustee filed a lawsuit against Burlington in the 1<sup>st</sup> Judicial District Court for the County of Santa Fe, State of New Mexico. The case is styled Compass Bank, in its Capacity as Trustee of the San Juan Basin Royalty Trust v. Burlington Resources Oil & Gas Company LP and BROG GP LLC, No. D-101-CV-2014-01765. The Trust asserts claims for breach of contract and breach of the implied covenant of good faith and fair dealing, and seeks a declaratory judgment arising out of a number of unresolved revenue and expense audit exceptions asserted by the Trust's auditors. More particularly, the claims involve Burlington's failure to properly account for and pay net overriding royalty interests to the Trust with respect to oil and gas production from numerous properties in the San Juan Basin of northwestern New Mexico. Based on information currently available to the Trust and its auditors, the Trust seeks monetary relief (including actual and punitive damages, costs, expenses, interest and attorney fees) in excess of \$12,000,000, along with specific performance of certain contractual obligations, declaratory relief and a judgment for other relief to which it may show itself to be justly entitled. Burlington has filed an answer and the parties have commenced discovery, which is in its early stages.

On March 14, 2008, Burlington notified the Trust that the distribution for March would be reduced by \$4,921,578. Burlington described this amount as the Trust's portion of what Burlington 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 has objected to Burlington's unilateral decision to deduct any amount of the settlement paid by Burlington from the distributions payable to the Trust and formally complained of that action as part of the 2014 Litigation. The Trust argues that no part of the settlement should have been allocated to the Trust because the claim which gave rise to the settlement was presented to Burlington for payment prior to the effective date of a mutual release of all claims entered into by Burlington and the Trust in 1996. In the alternative, the Trust contends that even if Burlington's allocation of part of the Wright settlement was not barred by the mutual release, the amount allocated to the Trust by Burlington was improper and excessive.

Burlington has informed the Trust that pursuant to an Order to Perform issued by the Minerals Management Service (MMS) dated June 10, 1998 (the MMS Order), 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 Burlington's dual accounting calculations on Native American leases were based on less than major portion prices. In 2000, Burlington and the Jicarilla entered into a settlement agreement resolving the issues associated with the dual accounting calculation. The major portion calculation issue remains outstanding. Burlington takes the position that a judgment or settlement could entitle Burlington to reimbursement from the Trust for past periods.

In 2007 Burlington obtained an Administrative Order from the Department of the Interior (the DOI) rejecting that portion of the MMS Order requiring Burlington to calculate and pay additional royalties based on the major portion price derived by the MMS. The Jicarilla filed suit solely against the DOI 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) seeking 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. In 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 by Memorandum Order dated October 7, 2011, remanded the matter to the DOI for further proceedings. While a judgment or settlement in the DOI Case could impact the Royalty Income of the Trust, Burlington has informed the Trust that it does not have sufficient information to estimate a range of loss for the Trust because the DOI has not provided a major portion calculation for the January 1984 to February 1988 time period as required by the July 16, 2010 Court of Appeals ruling described above. Burlington indicates that the situation will not be alleviated until the DOI provides Burlington with a new Order to Perform or similar notice, but that it cannot predict when or if the DOI will provide such information or notice. The Trust's consultants will continue to monitor development in this matter and analyze the appropriateness of the allocation, if any, by Burlington of any portion of any settlement or judgment in calculating the Royalty.

**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 November 10, 2014, 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 November 10, 2014, 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, 300 W. 7th Street, Suite B, Fort Worth, Texas 76102.

\*\* 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: November 10, 2014

(The Trust has no directors or executive officers.)

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**INDEX TO EXHIBITS**

**Exhibit**

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