

SAN JUAN BASIN ROYALTY TRUST

Form 10-K

February 29, 2008

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

Form 10-K

(Mark One)

- ☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2007
- OR**
- ☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**
For the transition period from to

Commission file number 1-8032

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

(Address of principal executive offices)

76116

(Zip Code)

(866) 809-4553

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Units of Beneficial Interest	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

None

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☒

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Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒

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 <input checked="" type="radio"/>	Accelerated filer <input type="radio"/>	Non-accelerated filer <input type="radio"/> (Do not check if a smaller reporting company)	Smaller Reporting company <input type="radio"/>
--	--	---	--

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

State the aggregate market value of the Units of Beneficial Interest held by non-affiliates of the registrant as of June 30, 2007: \$1,482,120,022.

At February 28, 2008, there were 46,608,796 Units of Beneficial Interest of the Trust outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Units of Beneficial Interest at page 2; Description of the Properties at page 5; Trustee's Discussion and Analysis at pages 5 through 11; and Statements of Assets, Liabilities and Trust Corpus, Statements of Distributable Income, Statements of Changes in Trust Corpus, Notes to Financial Statements, and Report of Independent Registered Public Accounting Firm at page 13 et seq., in registrant's Annual Report to Unit Holders for the year ended December 31, 2007, are incorporated herein by reference for Item 5 (Market for Registrant's Units, Related Security Holder Matters and Issuer Purchases of Units), Item 7 (Trustee's Discussion and Analysis of Financial Condition and Results of Operation) and Item 8 (Financial Statements and Supplementary Data) of Part II of this Report.

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PART I

Certain information included in this Annual Report on Form 10-K contains, and other materials filed or to be filed by the San Juan Basin Royalty Trust (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 within the meaning of Section 21E of the Securities Exchange Act of 1934 and Section 27A of the Securities Act of 1933. 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," "assume," "believe," "plan," "intend," or other words that convey the uncertainty of events or outcomes. Such statements reflect Burlington Resources Oil & Gas Company LP's ("BROG"), the working interest owner's, current view with respect to future events; are based on an assessment of, and are subject to, a variety of factors deemed relevant by Compass Bank, the Trustee of the Trust, 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.

ITEM 1. BUSINESS

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 (as a result of the merger discussed below). The principal office of the Trust is located at 2525 Ridgmar Boulevard, Suite 100, Fort Worth, Texas 76116, Attention: Trust Department (telephone number (866) 809-4553). The Trust maintains a website at www.sjbrt.com. The Trust makes available (free of charge) its annual, quarterly and current reports (and any amendments thereto) filed with the Securities and Exchange Commission (the "SEC") through its website as soon as reasonably practicable after electronically filing or furnishing such material with or to the SEC.

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 at 7:00 a.m.

On March 24, 2006 Compass Bancshares Inc., the parent company of Compass Bank, completed its acquisition of TexasBanc Holding Co., the parent company of TexasBank, the prior trustee of the Trust. On that same date, TexasBank merged with Compass Bank, and as a result, Compass Bank succeeded TexasBank as Trustee under the terms of the Indenture.

On September 7, 2007, Compass Bancshares, Inc. was acquired by Banco Bilbao Vizcaya Argentaria, S.A. ("BBVA") and is now a wholly-owned subsidiary of BBVA.

The Royalty was carved out of and now burdens the Underlying Properties as more particularly described under Item 2. Properties herein.

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 tradeable Unit for

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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.

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 then distribute the remaining available income to the Unit Holders. The Trust is not empowered to carry on any business activity and has no employees. All administrative functions are performed by the Trustee.

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, 2525 Ridgmar Boulevard, Suite 100, Fort Worth, Texas 76116, telephone number 1-866-809-4553, email address: sjt@compassbank.com, 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 tax information is generally posted by the Trustee at www.sjbrt.com.

The Trust received approximately \$113.8 million, \$136.3 million and \$153.9 million in Royalty Income from BROG in each of the fiscal years ended December 31, 2007, 2006 and 2005, respectively. After deducting administrative expenses and accounting for interest income and any change in cash reserves, the Trust distributed approximately \$113.2 million, \$135.9 million and \$151.6 million to Unit Holders in each of the fiscal years ended December 31, 2007, 2006 and 2005, respectively. The Trust's corpus was approximately \$19.9 million, \$21.8 million and \$23.9 million as of December 31, 2007, 2006 and 2005, respectively.

The term net proceeds, as used in the Conveyance, means the excess of gross proceeds received by BROG during a particular period over production costs for such period. Gross proceeds means the amount received by BROG (or any subsequent owner of the Underlying Properties) from the sale of the production attributable to the Underlying Properties subject to certain adjustments. Production costs generally means costs incurred on an accrual basis by BROG in operating the Underlying Properties, including both capital and non-capital costs. For example, these costs include development drilling, production and processing costs, applicable taxes and operating charges. If production costs exceed gross proceeds in any month, the excess is recovered out of future gross proceeds prior to the making of further payment to the Trust, but the Trust is not otherwise liable for any production costs or other costs or liabilities attributable to the Underlying Properties or the minerals produced therefrom. If at any time the Trust receives more than the amount due under the Royalty, it shall not be obligated to return such overpayment, but the amounts payable to it for any subsequent period shall be reduced by such amount, plus interest, at a rate specified in the Conveyance.

Compliance with state and federal environmental protection laws could reduce the Royalty Income received by the Trust. Costs of complying with such laws and regulations affect the production costs incurred by BROG in operating the Underlying Properties and may also affect capital expenditures by BROG. The Trust has no information regarding any estimated capital expenditures by BROG specifically allocable to environmental control facilities in the current or succeeding fiscal years.

Certain of the Underlying Properties are operated by BROG with the obligation to conduct its operations in accordance with reasonable and prudent business judgment and good oil and gas field practices. As operator, BROG has the right to abandon any well when, in its opinion, such well ceases to produce or is not capable of producing oil and gas in paying quantities. BROG also is responsible, subject to the terms of an agreement with the Trust, for marketing the production from such properties, either under existing sales contracts or under future arrangements, at the best prices and on the best terms it shall deem reasonably obtainable in the circumstances. Additionally, BROG

has the obligation to maintain books and records sufficient to determine the amounts payable to the Trustee.

Proceeds from production in the first month are generally received by BROG in the second month, the net proceeds attributable to the Royalty are paid by BROG to the Trustee in the third month, and distribution by the Trustee to the Unit Holders is made in the fourth month. Unit Holders of record as of the last business day of each month (the monthly record date) will be entitled to receive the calculated monthly distribution amount for such

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month on or before ten business days after the monthly record date. The amount of each monthly distribution will generally be determined and announced ten days before the monthly record date. The aggregate monthly distribution amount is the excess of (i) the net proceeds attributable to the Royalty paid to the Trustee, plus any decrease in cash reserves previously established for contingent liabilities and any other cash receipts of the Trust, over (ii) the expenses and payments of liabilities of the Trust, plus any net increase in cash reserves for contingent liabilities.

Cash being held by the Trustee as a reserve for liabilities or contingencies (which reserves may be established by the Trustee in its discretion) or pending distribution is placed, in the Trustee's discretion, in obligations issued by (or unconditionally guaranteed by) the United States or any agency thereof, repurchase agreements secured by obligations issued by the United States or any agency thereof, certificates of deposit of banks having capital, surplus and undivided profits in excess of \$50,000,000, or money market funds that have been rated at least AAm by Standard & Poor's and at least Aa by Moody's, subject, in each case, to certain other qualifying conditions.

The Underlying Properties are primarily gas producing properties. Normally there is a greater demand for gas in the winter months than during the rest of the year. Otherwise, the Royalty Income is not subject to seasonal factors nor in any manner related to or dependent upon patents, licenses, franchises or concessions. The Trust conducts no research activities.

The exploration for and the production of gas and oil is a speculative business. The Trust has no means of ensuring continued income from the Royalty at the present level or otherwise. In addition, fluctuations in prices and supplies of gas and oil and the effect these fluctuations might have on royalty income to the Trust and on reserves net to the Trust cannot be accurately projected. The Trustee has no information with which to make any projections beyond information on economic conditions that is generally available to the public and thus is unwilling to make any such projections.

ITEM 1A. RISK FACTORS

Although risk factors are described elsewhere in this Annual Report on Form 10-K, the following is a summary of the principal risks associated with an investment in Units of the Trust.

Oil and gas prices fluctuate due to a number of factors, and lower prices will reduce net proceeds to the Trust and distributions to Unit Holders.

The Trust's monthly distributions are highly dependent upon the prices realized from the sale of gas and, to a lesser extent, oil. Oil and gas prices can fluctuate widely on a month-to-month basis in response to a variety of factors that are beyond the control of the Trust and BROG. Factors that contribute to price fluctuation include, among others:

- political conditions worldwide, in particular political disruption, war or other armed conflicts in oil producing regions;

- worldwide economic conditions;

- weather conditions;

- the supply and price of foreign oil and gas, including liquefied natural gas;

- the level of consumer demand;

- the price and availability of alternative fuels;

the proximity to, and capacity of, transportation facilities; and

the effect of worldwide energy conservation measures.

Moreover, government regulations, such as regulation of natural gas transportation and price controls, can affect product prices in the long term.

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Lower oil and gas prices may reduce the amount of oil and gas that is economic to produce and reduce net profits to the Trust. The volatility of energy prices reduces the predictability of future cash distributions to Unit Holders.

Increased costs of production and development will result in decreased Trust distributions.

Production and development costs attributable to the Underlying Properties are deducted in the calculation of net proceeds. Accordingly, higher or lower production and development costs, without concurrent increases in revenues, directly decrease or increase the share of net proceeds paid to the Trust as Royalty Income.

If development and production costs of the Underlying Properties exceed the proceeds of production from the Underlying Properties, such excess costs are carried forward and the Trust will not receive a share of net proceeds for the Underlying Properties until future net proceeds from production from such properties exceed the total of the excess costs. Development activities may not generate sufficient additional revenue to repay the costs; however, the Trust is not obligated to repay the excess costs except through future production.

Trust reserve estimates depend on many assumptions that may prove to be inaccurate, which could cause both estimated reserves and estimated future revenues to be too high.

The value of the Units of the Trust depends upon, among other things, the amount of reserves attributable to the Royalty and the estimated future value of the reserves. Estimating reserves is inherently uncertain. Ultimately, actual production, revenues and expenditures for the Underlying Properties will vary from estimates and those variations could be material. Petroleum engineers consider many factors and make assumptions in estimating reserves. Those factors and assumptions include:

historical production from the area compared with production rates from similar producing areas;

the assumed effect of governmental regulation; and

assumptions about future commodity prices, production and development costs, severance and excise taxes, and capital expenditures.

Changes in these assumptions can materially change reserve estimates. The reserve data included herein are estimates only and are subject to many uncertainties. Actual quantities of oil and natural gas may differ considerably from the amounts set forth herein. In addition, different reserve engineers may make different estimates of reserve quantities and cash flows based upon the same available data.

The operators of the Underlying Properties are subject to extensive governmental regulation.

Oil and gas operations have been, and in the future will be, affected by federal, state and local laws and regulations and other political developments, such as price or gathering rate controls and environmental protection regulations.

Operating risks for BROG and other operators of the Underlying Properties can adversely affect Trust distributions.

Royalty Income payable to the Trust is derived from the sale of natural gas and oil production following the gathering and processing of those minerals, which operations are subject to risk inherent in such activities, such as blowouts, cratering, explosions, uncontrollable flows of oil, gas or well fluids, fires, pollution and other environmental risks and litigation concerning routine and extraordinary business activities and events. These risks could result in substantial losses which are deducted in calculating the net proceeds paid to the Trust due to injury and loss of life, severe

damage to and destruction of property and equipment, pollution and other environmental damage and suspension of operations.

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None of the Trustee, the Trust nor the Unit Holders control the operation or development of the Underlying Properties.

Neither the Trustee nor the Unit Holders can influence or control the operation or future development of the Underlying Properties. The Underlying Properties are owned by BROG and BROG operates the majority of such properties and handles the calculation of the net proceeds attributable to the Royalty and the payment of Royalty Income to the Trust.

The Royalty can be sold and the Trust can be terminated in certain circumstances.

The Trust will be terminated and the Trustee must sell the Royalty if holders of at least 75% of the Units approve the sale or vote to terminate the Trust, or if the Trust's gross revenue for each of two successive years is less than \$1,000,000 per year. Following any such termination and liquidation, the net proceeds of any sale will be distributed to the Unit Holders and Unit Holders will receive no further distributions from the Trust. We cannot assure you that any such sale will be on terms acceptable to all Unit Holders.

Mineral properties, such as the Underlying Properties, are depleting assets and, if BROG or other operators of the Underlying Properties do not perform additional development projects, the assets may deplete faster than expected.

The Royalty Income payable to the Trust is derived from the sale of depleting assets. Accordingly, the portion of the distributions to Unit Holders (to the extent of depletion taken) may be considered a return of capital. The reduction in proved reserve quantities is a common measure of depletion. Future maintenance and development projects on the Underlying Properties will affect the quantity of proved reserves. The timing and size of these projects will depend on the market prices of natural gas. If BROG does not implement additional maintenance and development projects, the future rate of production decline of proved reserves may be higher than the rate currently expected by the Trust.

Unit Holders have limited voting rights.

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

ITEM 1B. UNRESOLVED STAFF COMMENTS

During the period of time that is not less than 180 days before the end of the Trust's fiscal year to which this Annual Report on Form 10-K relates, the Trust did not receive any written comments from the SEC staff regarding its periodic or current reports under the Securities Exchange Act of 1934 that remain unresolved.

ITEM 2. PROPERTIES

The Royalty conveyed to the Trust was carved out of Southland Royalty's (now BROG's) working interests and royalty interests in certain properties situated in the San Juan Basin in northwestern New Mexico. See Item 1. Business for information on the conveyance of the Royalty to the Trust. References below to gross wells and acres are to the interests of all persons owning interests therein, while references to net are to the interests of BROG (from which the Royalty was carved) in such wells and acres.

Unless otherwise indicated, the following information in this Item 2 is based upon data and information furnished to the Trustee by BROG.

Producing Acreage, Wells and Drilling

The Underlying Properties consist of working interests, royalty interests, overriding royalty interests and other contractual rights in 151,900 gross (119,000 net) producing acres in San Juan, Rio Arriba and Sandoval Counties of

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northwestern New Mexico and 3,823 gross (1,111 net) wells, calculated on a well bore basis and not including multiple completions as separate wells. Of those wells, seven gross (5.50 net) are oil wells and the balance are gas wells. BROG reports that approximately 739 of the wells are multiple completion wells resulting in a total of 4,599 completions. The Trust has inquired of BROG whether the acreage is developed or undeveloped. BROG has informed the Trust that all of the subject acreage is held by production, and even though it has not been fully developed in every formation, BROG has classified all of such acreage as developed. Production from conventional gas wells is primarily from the Pictured Cliffs, Mesaverde and Dakota formations. During 1988, Southland Royalty began development of coal seam reserves in the Fruitland Coal formation.

The Royalty conveyed to the Trust is limited to the base of the Dakota formation, which is currently the deepest significant producing formation under acreage affected by the Royalty. Rights to production, if any, from deeper formations are retained by BROG.

During 2007, in calculating Royalty Income, BROG deducted \$27.4 million of capital expenditures for projects, including drilling and completion of 45 gross (21.47 net) conventional wells and 21 gross (15.31 net) coal seam wells. There were ten gross (0.35 net) conventional wells and nine gross (4.52 net) coal seam wells in progress as of December 31, 2007. All of the wells were development wells.

The aggregate capital expenditures deducted by BROG in calculating Royalty Income for 2007 include approximately \$16.8 million attributable to the capital budgets for prior years. This occurs because projects within a given year's budget may extend into subsequent years, with capital expenditures attributable to those projects used in calculating distributable income to the Trust in those subsequent years. Further, BROG's accounting period for capital expenditures runs through November 30 of each calendar year, such that capital expenditures incurred in December of each year are actually accounted for as part of the following year's capital expenditures. In addition, with respect to wells not operated by BROG, BROG's share of capital expenditures may not actually be paid by it until the year or years after those expenses were incurred by the operator.

Capital expenditures of approximately \$10.6 million for 2007 budgeted projects were used in calculating net proceeds payable to the Trust in calendar year 2007. The \$10.6 million covered 140 projects, including the drilling of 79 new wells operated by BROG and one new well operated by a third party. New drilling activity was at an aggregate cost of approximately \$7.8 million. The balance of the expenditures was attributable to the workover of existing wells and the maintenance and improvement of production facilities. BROG reports that an additional approximately \$5 million in capital expenditures for budgeted 2007 projects is estimated to be spent in 2008.

During 2006, in calculating Royalty Income, BROG deducted approximately \$39.2 million of capital expenditures for projects, including drilling a completion of 115 gross (24.14 net) conventional wells, two gross (0.003 net) payadds, two gross (1.74 net) recompletions, three gross (2.50 net) restimulations, 44 gross (14.63 net) coal seam wells, seven gross (0.28 net) coal seam payadds, two gross (0.48 net) coal seam recompletions, and two gross (0.08 net) coal seam miscellaneous capital projects. There were 100 gross (26.27 net) conventional wells, 14 gross (0.39 net) payadds, seven gross (3.49 net) recompletions, six gross (4.02 net) restimulations, four gross (0.02 net) miscellaneous capital projects, 28 gross (11.79 net) coal seam wells, one gross (0.04 net) coal seam payadd, five gross (3.57 net) coal seam recompletions, and two gross (0.004 net) coal seam restimulations in progress as of December 31, 2006. All of the wells were development wells. A payadd is the completion of an additional productive interval in an existing completed zone in a well.

During 2005, in calculating Royalty Income, BROG deducted approximately \$19.1 million of capital expenditures for projects, including drilling and completion of 38 gross (2.72 net) conventional wells, five gross (0.011 net) payadds, one gross (0.57 net) conventional restimulation, 25 gross (2.89 net) coal seam wells, one gross (0.99 net) coal seam recavitation, two gross (0.61 net) coal seam recompletions, and five gross (0.20 net) miscellaneous coal seam capital

projects. There were 110 gross (19.08 net) conventional wells, eight gross (1.73 net) payadds, six gross (3.30 net) conventional recompletions, seven gross (5.04 net) conventional restimulations, 59 gross (10.06 net) coal seam wells, five gross (2.32 net) coal seam recompletions, and one gross (0.04 net) miscellaneous coal seam capital project in progress as of December 31, 2005. All of the wells were development wells.

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BROG has informed the Trust that it has revised the 2008 budget for capital expenditures for the Underlying Properties to \$24.4 million, an increase from the \$18.3 million that was previously disclosed in the Trust's press release dated February 19, 2008. Approximately 35% of the planned expenditures will be on Fruitland Coal formation projects with the remainder to be spent on conventional projects. In addition, BROG estimates that during 2008 it will incur capital expenses in the amount of approximately \$5 million attributable to the capital budgets for 2007 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 2008 could range from \$15 million to \$50 million.

BROG anticipates 361 projects in 2008 at an aggregate cost of \$24.4 million. Approximately \$19.7 million of that budget is allocable to 70 new wells, including 37 wells scheduled to be dually completed in the Mesaverde and Dakota formations at an aggregate projected cost of approximately \$9.4 million, and four wells to be completed to the Dakota formation at an aggregate cost of approximately \$2.3 million. BROG indicates that 16 of the new wells, at an aggregate cost of approximately \$7.3 million, are projected to be drilled to formations producing coal seam gas. BROG also mentioned that the possible implementation of new rules restricting the use of open reserve pits could reduce the number of projects due to increased compliance costs. Of the \$5 million attributable to the budgets for prior years, approximately \$2 million is allocable to new wells to be operated by BROG; an estimated \$1 million is allocable to new wells to be operated by others; and the \$2 million balance will be applied to miscellaneous capital projects such as workovers and operated facility projects.

In February 2002, BROG informed the Trust that the New Mexico Oil Conservation Division (the "OCD") had approved plans for 80-acre infill drilling of the Dakota formation in the San Juan Basin. In July 2003, the OCD approved 160-acre density in the Fruitland Coal formation. Eighty-acre density has been permitted in the Mesaverde formation since 1997. In January 2008, BROG reported to the Trust that it will participate in a study involving a total of 16 test wells to be completed to the Mesaverde and/or Dakota formations, with some of the test wells to be drilled on a 40-acre spacing basis and others on a 20-acre spacing. In addition, BROG is scheduled to participate in a pilot project for the drilling of four horizontal wells, with two to be completed to each of the Dakota and Mesaverde formations. Although none of the four horizontal wells are to be drilled on acreage burdened by the Royalty, the pilot project could have implications for the San Juan Basin generally.

Oil and Gas Production

The Trust recognizes production during the month in which the related net proceeds attributable to the Royalty are paid to the Trust. Royalty Income for a calendar year is based on the actual gas and oil production during the period beginning with November of the preceding calendar year through October of the current calendar year. Production of oil and gas and related average sales prices attributable to the Royalty for the three years ended December 31, 2007, were as follows:

	2007		2006		2005	
	Gas (Mcf)	Oil (Bbls)	Gas (Mcf)	Oil (Bbls)	Gas (Mcf)	Oil (Bbls)
Production	20,116,806	35,129	22,475,405	40,702	26,600,644	43,142
Average Price	\$ 6.11	\$ 63.14	\$ 6.55	\$ 61.30	\$ 6.27	\$ 49.62

Production volumes and costs attributable to the Underlying Properties for the three years ended December 31, 2007, were as follows:

	2007	2006	2005
Production	36,961,349 Mcf	40,900,570 Mcf	42,867,162 Mcf
Total Production Costs	\$ 77,932,758	\$ 88,625,021	\$ 68,607,709
Lease Operating Expenses	\$ 27,947,790	\$ 22,463,687	\$ 21,234,459
Average Lifting Cost per Unit of Production	\$.7561	\$.5492	\$.4953

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Pricing Information

Gas produced in the San Juan Basin is sold in both interstate and intrastate commerce. Reference is made to the discussion contained herein under Regulation for information as to federal regulation of prices of oil and natural gas. Gas production from the Underlying Properties totaled 36,961,349 Mcf during 2007.

On September 4, 1996, the Trustee announced a settlement of litigation filed by the Trustee against BROG (the 1996 Settlement). In the 1996 Settlement, agreement was reached, among other things, regarding marketing arrangements for the sale of those gas, oil and natural gas liquids products from the Underlying Properties going forward as follows:

- (i) BROG agreed that all subsequent contracts for the sale of gas from the Underlying Properties would require the written approval of an independent gas marketing consultant acceptable to the Trust;
- (ii) BROG will continue to market the oil and natural gas liquids from the Underlying Properties but will make payments to the Trust based on actual proceeds from such sales, and BROG will no longer use posted prices as the basis for calculating proceeds to the Trust nor make a deduction for marketing fees associated with sales of oil or natural gas liquids products; and
- (iii) The independent marketer of the gas from the Underlying Properties is entitled to use of BROG's current gas transportation, gathering, processing and treating agreements with third parties, at least through the remainder of their primary terms.

BROG previously entered into two contracts for the sale of all volumes of gas produced from the Underlying Properties. These contracts provided for (i) the sale of such gas to Duke Energy and Marketing, L.L.C. and PNM Gas Services (PNM), respectively, (ii) the delivery of such gas at various delivery points through March 31, 2005, and from year-to-year thereafter until terminated by either party on 12 months' notice, and (iii) the sale of such gas at prices which fluctuate in accordance with published indices for gas sold in the San Juan Basin of northwestern New Mexico. Effective January 1, 2004, the rights and obligations of Duke Energy and Marketing L.L.C. were assumed by ConocoPhillips Company (ConocoPhillips) pursuant to an Assignment and Novation Agreement. By correspondence dated March 25, 2004, BROG notified ConocoPhillips of BROG's election to terminate such contract as of March 31, 2005. BROG then prepared a form of request for proposal and circulated it to a number of potential purchasers, including ConocoPhillips, inviting them to bid for the purchase of the gas currently sold under the contract expiring March 31, 2005. Effective as of April 1, 2005, BROG entered into two new contracts for the sale of all volumes of gas produced from the Underlying Properties and formerly sold to ConocoPhillips. These new contracts provide for (i) the sale of such gas to ChevronTexaco Natural Gas, a division of Chevron U.S.A. Inc. (ChevronTexaco), and Coral Energy Resources, L.P. (Coral), respectively, (ii) the delivery of such gas at various delivery points through March 31, 2007, and from year-to-year thereafter until terminated by either party on 12 months' notice, and (iii) 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. With respect to BROG's contract with PNM, BROG and PNM entered into a letter agreement dated January 31, 2005, pursuant to which the term of that contract was adjusted to coincide with the contracts with ChevronTexaco and Coral. Neither BROG nor any of ChevronTexaco, Coral nor PNM gave notice by March 31, 2007 to terminate the three contracts described above for the sale of all volumes of gas produced from the Underlying Properties and, accordingly, the terms of those contracts have been extended at least through March 31, 2009. On January 15, 2008, PNM Resources, the corporate parent of PNM, announced a definitive agreement to sell its natural gas operations to a subsidiary of Continental Energy Systems. The sale is conditioned upon regulatory approval and customary closing conditions and is currently expected to close by the end of 2008.

Confidentiality agreements with 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.

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The following are definitions adopted by the SEC and the Financial Accounting Standards Board which are applicable to terms used within this Annual Report on Form 10-K:

Estimated future net revenues are computed by applying current prices of oil and gas (with consideration of price changes only to the extent provided by contractual arrangements and allowed by federal regulation) to estimated future production of proved oil and gas reserves as of the date of the latest balance sheet presented, less estimated future expenditures (based on current costs) to be incurred in developing and producing the proved reserves, and assuming continuation of existing economic conditions. Estimated future net revenues are sometimes referred to in this Annual Report on Form 10-K as estimated future net cash flows.

Present value of estimated future net revenues is computed using the estimated future net revenues (as defined above) and a discount rate of 10%.

Proved developed reserves are those reserves that can be expected to be recovered through existing wells with existing equipment and operating methods. See 17 CFR 210.4-10(a)(3).

Proved reserves are the estimated quantities of crude oil, natural gas, and natural gas liquids which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known oil and gas reservoirs under existing economic and operating conditions. See 17 CFR 210.4-10(a)(2) (2)(iii).

Proved undeveloped reserves are those reserves that are expected to be recovered from new wells on undrilled acreage, or from existing wells where a relatively major expenditure is required for recompletion. See 17 CFR 210.4-10(a)(4).

The independent petroleum engineers' reports as to the proved oil and gas reserves as of December 31, 2005, 2006 and 2007, were prepared by Cawley, Gillespie & Associates, Inc. The following table presents a reconciliation of proved reserve quantities attributable to the Royalty from December 31, 2004, to December 31, 2007, (in thousands):

	Crude Oil (Bbls)	Natural Gas (Mcf)
Reserves as of December 31, 2004	459	256,936
Revisions of previous estimates	15	14,401
Extensions, discoveries and other additions	23	17,023
Production	(43)	(26,601)
Reserves as of December 31, 2005	454	261,759
Revisions of previous estimates	(33)	(27,467)
Extensions, discoveries and other additions	20	8,644
Production	(41)	(22,475)
Reserves as of December 31, 2006	400	220,461

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Revisions of previous estimates	3	(15,263)
Extensions, discoveries and other additions	20	9,774
Production	(35)	(20,117)
Reserves as of December 31, 2007	388	194,855

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Estimated quantities of proved developed reserves of crude oil and natural gas as of December 31, 2007, 2006 and 2005 were as follows (in thousands):

	2007	2006	2005
Crude Oil (Bbls)	333	357	395
Natural Gas (Mcf)	171,165	197,466	231,235

Generally, the calculation of oil and gas reserves takes into account a comparison of the value of the oil or gas to the cost of producing those minerals, in an attempt to cause minerals in the ground to be included in reserve estimates only to the extent that the anticipated costs of production will be exceeded by the anticipated sales revenue.

Accordingly, an increase in sales price and/or a decrease in production cost can itself result in an increase in estimated reserves and declining prices and/or increasing costs can result in reserves reported at less than the physical volumes actually thought to exist. The Financial Accounting Standards Board requires supplemental disclosures for oil and gas producers based on a standardized measure of discounted future net cash flows relating to proved oil and gas reserve quantities. Under this disclosure, future cash inflows are estimated by applying year-end prices of oil and gas relating to the enterprise's proved reserves to the year-end quantities of those reserves, less estimated future expenditures (based on current costs) of developing and producing the proved reserves, and assuming continuation of existing economic conditions. Future price changes are only considered to the extent provided by contractual arrangements in existence at year-end. The standardized measure of discounted future net cash flows is achieved by using a discount rate of 10% a year to reflect the timing of future net cash flows relating to proved oil and gas reserves.

Estimates of proved oil and gas reserves are by their nature imprecise. Estimates of future net revenue attributable to proved reserves are sensitive to the unpredictable prices of oil and gas and other variables. Accordingly, under the allocation method used to derive the Trust's quantity of proved reserves, changes in prices will result in changes in quantities of proved oil and gas reserves and estimated future net revenues.

The 2007, 2006 and 2005 changes in the standardized measure of discounted future net cash flows related to future royalty income from proved reserves are as follows (in thousands):

	2007	2006	2005
Balance, January 1	\$ 746,327	\$ 1,090,324	\$ 756,017
Revisions of prior-year estimates, change in prices and other	7,282	(345,237)	339,865
Extensions, discoveries and other additions	36,319	28,520	72,698
Accretion of discount	74,633	109,032	75,602
Royalty Income	(113,803)	(136,312)	(153,858)
Balance, December 31	\$ 750,758	\$ 746,327	