# 2010

## SAN JUAN BASIN ROYALTY TRUST

**2ND** QUARTER REPORT

## TO UNIT HOLDERS

The Trust received Royalty income of $22,450,139 and interest income of $4,776 during the second quarter of 2010. There was no change in cash reserves. After deducting administrative expenses of $774,334, distributable income for the quarter was $21,680,581 ($0.465161 per Unit). In the second quarter of 2009, Royalty income was $2,474,109, interest income was $806, administrative expenses were $686,688 and distributable income was $1,788,227 ($0.038367 per Unit). Based on 46,608,796 Units outstanding, the per-Unit distributions during the second quarter of 2010 were as follows:

| | |
|---|---|
| April | **$.147202** |
| May | **.202553** |
| June | **.115406** |
| QUARTER TOTAL | **$.465161** |

The Royalty income distributed in the second quarter of 2010 was higher than that distributed in the second quarter of 2009, primarily due to an increase in the average gas price from $2.82 per Mcf for the second quarter of 2009 to $5.12 per Mcf for the second quarter of 2010, but also as a result of material reductions in capital expenditures and the receipt of $2,600,000 in settlement of the legal proceedings described below. Interest income was higher for the quarter ended June 30, 2010 as compared to the quarter ended June 30, 2009, primarily due to additional funds available for investment. Administrative expenses were higher in 2010 primarily as a result of differences in timing in the receipt and payment of these expenses and also due to increased costs associated with the litigation described below.

The capital costs attributable to the Underlying Properties for the second quarter of 2010 and deducted by Burlington Resources Oil & Gas Company LP ("BROG") in calculating Royalty income were approximately $2.2 million as compared to approximately $11 million of capital costs in the second quarter of 2009. BROG has informed the Trust that its budget for capital expenditures for the Underlying Properties in 2010 is estimated at $17.9 million. In addition, BROG estimates that during 2010 it will incur capital expenses in the amount of approximately $6.8 million attributable to the capital budgets for 2009 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 2010 could range from $10 million to $45 million.

BROG anticipates 305 projects in 2010. Approximately $7.2 million of the $17.9 million budget is allocable to 43 new wells, including 41 wells scheduled to be dually completed in the Mesaverde and Dakota formations. BROG indicates that two of the new wells are projected to be drilled to Fruitland Coal or Pictured Cliffs formations. Approximately $3.8 million will be spent on workovers and facilities projects. Of the $6.8 million attributable to the budgets for prior years, approximately $4.4 million is allocable to new wells and the $2.4 million balance will be applied to miscellaneous capital projects such as workovers and operated facility projects. BROG mentioned that the possible implementation of new air quality rules and rules requiring the minimization of surface disturbances, implementation of closed-loop systems for the disposal of drilling fluids and cuttings, and the restricted use of open reserve pits could reduce the number of projects due to increased compliance costs.

BROG has informed the Trust that lease operating expenses and property taxes were $7,842,642 and $270,213, respectively, for the second quarter of 2010, as compared to $7,813,298 and $213,289, respectively, for the second quarter of 2009. Many joint operating agreements call for the increase or decrease in rates charged for the drilling and operation of wells based upon an overhead adjustment factor published annually by the Council for Petroleum Accountants Societies. That factor was set at +1.9% effective as of April 1, 2010.

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

There were eight gross (5.71 net) coal seam wells and 19 gross (4.93 net) conventional wells completed on the Underlying Properties as of June 30, 2009. Eight gross (4.03 net) coal seam wells and 20 gross (4.83 net) conventional wells were in progress at June 30, 2009.

There were 3,967 gross (1,163 net) producing wells being operated subject to the Royalty as of December 31, 2009, calculated on a well bore basis and not including multiple completions as separate wells.

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

Royalty income for the quarter ended June 30, 2010 is associated with actual gas and oil production during February 2010 through April 2010 from the Underlying Properties. Gas and oil sales from the Underlying Properties for the three months ended June 30, 2010 and 2009 were as follows:

| *Three Months Ended June 30,* | **2010** | 2009 |
|---|---|---|
| Gas: | | |
| Total sales (Mcf) | **7,710,876** | 8,511,072 |
| Mcf per day | **86,639** | 95,630 |
| Average price (per Mcf) | **$ 5.12** | $ 2.82 |
| Oil: | | |
| Total sales (Bbls) | **14,701** | 15,293 |
| Bbls per day | **165** | 172 |
| Average price (per Bbl) | **$71.54** | $36.58 |

During the second quarter of 2010, average gas prices were $2.30 per Mcf higher than the average prices reported during the second quarter of 2009. The average price per barrel of oil during the second quarter of 2010 was $34.96 per barrel higher than that received for the second quarter of 2009.

BROG entered into four contracts effective April 1, 2009, for the sale of all gas produced from the Underlying Properties other than the gas covered by a pre-existing contract with New Mexico Gas Company, Inc. ("NMGC"). The current purchasers are Chevron Natural Gas, a division of Chevron USA, Inc. ("Chevron"), Pacific Gas and Electric Company ("PG&E"), BP Energy Company, Macquarie Cook Energy LLC, and NMGC. All five of such contracts provide for (i) the delivery of such gas at various delivery points through March 31, 2011 and from year-to-year thereafter, until terminated by either party on 12 months' notice; 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.

In March 2010, notice of termination of each of the Chevron, BP Energy Company and Macquarie Cook Energy LLC contracts was given such that they will terminate effective March 31, 2011. Requests for proposal will be circulated to potential purchasers of those packages of gas covered by the expiring contracts with a view toward obtaining new contracts to be effective April 1, 2011. Neither BROG, PG&E, nor NMGC gave notice of termination of their contracts such that the terms of those two contracts have been automatically extended through at least March 31, 2012.

BROG contracts with Williams Four Corners, LLC ("WFC") and Enterprise Field Services, LLC ("EFS") for the gathering and processing of virtually all of the gas produced from the Underlying Properties. Four new contracts have been entered into with WFC to be effective for terms of 15 years commencing April 1, 2010. The new contracts will consolidate and replace 18 prior contracts with WFC. BROG indicates that the new contracts are anticipated to provide some modest reductions in fees and also improved services, including more rigorous line pressure controls and the right to install compression facilities as needed.

However, BROG reports that it has been unable to reach agreement with EFS on gathering and production contracts, and it has joined a group of 51 others in initiating an administrative proceeding before the New Mexico Public Utility Commission, complaining, *inter alia*, that EFS is insisting upon above-market rates and refusing to agree to essential pressure control services. Gas is currently being gathered and processed by EFS on a month-to-month basis. The Trustee will continue to monitor this matter as it may relate to the Trust.

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

On April 29, 2010, the Trust entered into a Settlement Agreement and Release of Claims intended to dispose of its claims against BROG relating to the Arbitration Award in its favor issued in November 2005. In litigation styled *San Juan Basin Royalty Trust vs. Burlington Resources Oil & Gas Company, L.P.*, No. D1329-CV-08-751, in the District Court of Sandoval County, New Mexico, 13th Judicial District, the Trust alleged breach of contract and breach of the covenant of good faith and fair dealing and sought a judgment for damages in the amount of $5,025,000, plus interest and punitive damages. The purpose of the arbitration was to resolve certain compliance audit issues. The arbitrator ruled in favor of the Trust on all five of the issues submitted to arbitration. BROG filed suit in Harris County, Texas alleging that the award should be modified or vacated, and seeking to recover its attorneys' fees. The trial court denied BROG's motion to vacate, granted the Trust's application to confirm and rendered a final judgment in favor of the Trust. BROG paid the award as it related to four of the five issues and appealed the award as to the fifth. In August 2007, the appellate court reversed the judgment of the trial court and vacated the award as it related to the unpaid balance.

With respect to that fifth issue, which was the subject of the appeal, the Trust had asked for damages based on either of two alternative claims. The appellate court ruled that the alternative claim selected by the arbitrator in awarding the Trust approximately $5,000,000 was not technically included within the scope of what the parties intended to submit to arbitration. The appellate court did not rule on whether or not the arbitrator properly decided the fifth issue in favor of the Trust. The litigation filed in New Mexico sought recovery on the claim which had been resolved in favor of the Trust by the arbitrator.

The appellate court also remanded the case to the District Court, where BROG pursued its claim for attorneys' fees and costs in the amount of approximately $500,000. Following a trial on the merits of BROG's claims conducted on June 3, 2009, the District Court ruled in favor of the Trust and ordered that BROG should take nothing in its claims against the Trust. BROG filed a Notice of Appeal as regards that ruling.

Following mediation conducted on April 8 and 23, 2010, BROG and the Trust entered into a settlement whereby BROG was to pay the Trust $2,600,000 and release its claims for attorneys' fees. Both the Trust's suit pending in New Mexico and BROG's Texas litigation were dismissed. The settlement payment due from BROG was paid to the Trust in May 2010.

Included in this report are the Condensed Statements of Assets, Liabilities and Trust Corpus as of June 30, 2010 (Unaudited), and December 31, 2009, and the Unaudited Condensed Statements of Distributable Income and of Change in Trust Corpus for the three months ended June 30, 2010 and 2009.

Unit holders of record for the second quarter of 2010 will continue to receive an individualized tax information letter on a quarterly and an annual basis. Unit holders owning units in nominee name may obtain monthly tax information from the Trust's website at www.sjbrt.com, or from the Trustee upon request.

Compass Bank, Trustee

L A Anderson

LEE ANN ANDERSON
*Vice President and Senior Trust Officer*

## CONDENSED STATEMENTS OF ASSETS, LIABILITIES AND TRUST CORPUS

| | June 30, 2010 | December 31, 2009 |
|---|---|---|
| **ASSETS** | *(Unaudited)* | |
| Cash and short-term investments | **$ 5,534,717** | $ 5,341,482 |
| Net overriding royalty interest in producing oil and gas properties (net of accumulated amortization of $117,473,547 and $116,431,797 at June 30, 2010 and December 31, 2009, respectively) | **15,801,981** | 16,843,731 |
| | **$ 21,336,698** | $ 22,185,213 |
| **LIABILITIES AND TRUST CORPUS** | | |
| Distribution payable to Unit Holders | **$ 5,378,928** | $ 5,185,693 |
| Cash reserves | **155,789** | 155,789 |
| Trust corpus—46,608,796 Units of beneficial interest authorized and outstanding | **15,801,981** | 16,843,731 |
| | **$ 21,336,698** | $ 22,185,213 |

## CONDENSED STATEMENTS OF DISTRIBUTABLE INCOME (UNAUDITED)

| | Three Months Ended June 30, 2010 | 2009 | Six Months Ended June 30, 2010 | 2009 |
|---|---|---|---|---|
| Royalty income | **$ 22,450,139** | $ 2,474,109 | **$ 44,452,655** | $ 12,024,685 |
| Interest income | **4,776** | 806 | **213,089[1]** | 3,411 |
| Total revenue | **22,454,915** | 2,474,915 | **44,665,744** | 12,028,096 |
| General and administrative expenditures | **774,334** | 686,688 | **1,455,845** | 1,270,433 |
| Distributable income | **$ 21,680,581** | $ 1,788,227 | **$ 43,209,899** | $ 10,757,663 |
| Distributable income per Unit (46,608,796 Units) | **$ 0.465161** | $ 0.038367 | **$ 0.927076** | $ 0.230807 |

*1) Includes $205,085 in interest due on late payment of gross proceeds as a result of the ongoing negotiation of compliance audit exceptions.*

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

| | Three Months Ended June 30, 2010 | 2009 | Six Months Ended June 30, 2010 | 2009 |
|---|---|---|---|---|
| Trust corpus, beginning of period | **$ 16,323,490** | $17,680,989 | **$ 16,843,731** | $ 17,927,498 |
| Amortization of net overriding royalty interest | **(521,509)** | (108,855) | **(1,041,750)** | (355,364) |
| Distributable income | **21,680,581** | 1,788,227 | **43,209,899** | 10,757,663 |
| Distributions declared | **(21,680,581)** | (1,788,227) | **(43,209,899)** | (10,757,663) |
| Trust corpus, end of period | **$ 15,801,981** | $17,572,134 | **$ 15,801,981** | $ 17,572,134 |

Royalty Income received by the Trust for the three months and six months ended June 30, 2010 and 2009, respectively, was computed as shown in the following table:

## CALCULATION OF ROYALTY INCOME

| | Three Months Ended June 30, 2010 | 2009 | Six Months Ended June 30, 2010 | 2009 |
|---|---|---|---|---|
| **GROSS PROCEEDS OF SALES FROM THE UNDERLYING PROPERTIES:** | | | | |
| Gas proceeds | **$ 42,960,392** | $24,014,580 | **$ 86,946,324** | $ 58,609,441 |
| Oil proceeds | **1,051,752** | 559,382 | **1,942,221** | 1,004,117 |
| Total | **44,012,144** | 24,573,962 | **88,888,545** | 59,613,558 |
| **LESS PRODUCTION COSTS:** | | | | |
| Severance tax—gas | **3,634,956** | 2,178,181 | **7,650,402** | 5,304,435 |
| Severance tax—oil | **97,737** | 56,179 | **179,888** | 98,975 |
| Other | | 1,020[1] | | 1,020[1] |
| Lease operating expense and property tax | **8,112,855** | 8,026,587 | **16,125,948** | 17,296,146 |
| Capital expenditures | **2,233,077** | 11,013,183 | **5,662,100** | 20,880,069 |
| Total | **14,078,625** | 21,275,150 | **29,618,338** | 43,580,645 |
| Net profits | **29,933,519** | 3,298,812 | **59,270,207** | 16,032,913 |
| Net overriding royalty interest | **75%** | 75% | **75%** | 75% |
| **ROYALTY INCOME** | **$ 22,450,139** | $ 2,474,109 | **$ 44,452,655** | $ 12,024,685 |

*1) Reflects the fee for BROG volume exchanges during the production month of April 2009.*

*These financial statements should be read in conjunction with the condensed financial statements and notes thereto included in the Trust's Form 10-Q filing for the quarterly period ending June 30, 2010.*

## GLOSSARY OF TERMS

**DISTRIBUTABLE INCOME:** An amount paid to Unit holders equal to the Royalty income received by the Trustee during a given period plus interest, less the general and administrative expenses of the Trust, adjusted by any changes in cash reserves.

**ROYALTY:** The principal asset of the Trust; the 75% net overriding royalty interest conveyed to the Trust on November 3, 1980, by Southland Royalty Company, the predecessor to BROG, which was carved out of the Underlying Properties.

**UNDERLYING PROPERTIES:** The working, royalty and other interests owned by Southland Royalty Company, the predecessor to BROG, in properties located in the San Juan Basin of northwestern New Mexico, out of which the Royalty was carved.

**UNITS OF BENEFICIAL INTEREST:** The units of ownership of the Trust, equal to the number of shares of common stock of Southland Royalty Company outstanding at the close of business on November 3, 1980.



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