

SAN JUAN BASIN ROYALTY TRUST

Form 10-Q

August 09, 2016

[Table of Contents](#)

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

x **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the Quarterly Period Ended June 30, 2016**

**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 August 9, 2016: 46,608,796



**Table of Contents**

**Table of Contents**

**PART I. FINANCIAL INFORMATION**

Item 1	<u>Financial Statements</u>	1
Item 2	<u>Trustee's Discussion and Analysis of Financial Condition and Results of Operations</u>	5
Item 3	<u>Quantitative and Qualitative Disclosures about Market Risk</u>	10
Item 4	<u>Controls and Procedures</u>	10

**PART II. OTHER INFORMATION**

Item 1	<u>Legal Proceedings</u>	10
Item 1A	<u>Risk Factors</u>	11
Item 2	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	11
Item 3	<u>Defaults Upon Senior Securities</u>	11
Item 4	<u>Mine Safety Disclosures</u>	11
Item 5	<u>Other Information</u>	11
Item 6	<u>Exhibits</u>	11

**SIGNATURE**

Table of Contents

## SAN JUAN BASIN ROYALTY TRUST

## PART I

## FINANCIAL INFORMATION

**Item 1. Financial Statements.**CONDENSED STATEMENTS OF ASSETS, LIABILITIES AND TRUST CORPUS

	June 30, 2016 (Unaudited)	December 31, 2015
<b>ASSETS</b>		
Cash and short-term investments	\$ 1,111,987	\$ 1,819,252
Net overriding royalty interest in producing oil and gas properties (net of accumulated amortization of \$124,854,922 and \$124,551,141 at June 30, 2016 and December 31, 2015, respectively)	8,420,606	8,724,387
	\$ 9,532,593	\$ 10,543,639
<b>LIABILITIES AND TRUST CORPUS</b>		
Distribution payable to Unit Holders	\$ 125,674	\$ 1,282,939
Cash reserves	986,313	536,313
Trust corpus 46,608,796 Units of beneficial interest authorized and outstanding	8,420,606	8,724,387
	\$ 9,532,593	\$ 10,543,639

*These Condensed Financial Statements should be read in conjunction with the accompanying Notes to Financial Statements included herein.*

**Table of Contents****CONDENSED STATEMENTS OF DISTRIBUTABLE INCOME (UNAUDITED)**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Royalty income	\$ 1,541,698	\$ 2,264,542	\$ 4,575,210	\$ 9,609,143
Interest income	596	497	1,254	80,444 <sup>(1)</sup>
Total revenue	1,542,294	2,265,039	4,576,464	9,689,587
General and administrative expenditures	(886,134)	(498,750)	(1,908,570)	(1,160,488)
Increase in cash reserves	(225,000)	(350,071)	(450,000)	(350,071)
Distributable income	\$ 431,160	\$ 1,416,218	\$ 2,217,894	\$ 8,179,028
Distributable income per Unit (46,608,796 Units)	\$ 0.009251	\$ 0.030385	\$ 0.047586	\$ 0.175483

(1) Includes \$78,884 in 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)**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Trust corpus, beginning of period	\$ 8,573,863	\$ 9,162,781	\$ 8,724,387	\$ 9,362,757
Amortization of net overriding royalty interest	(153,257)	(81,646)	(303,781)	(281,622)
Distributable income	431,160	1,416,218	2,217,894	8,179,028
Distributions declared	(431,160)	(1,416,218)	(2,217,894)	(8,179,028)
Trust corpus, end of period	\$ 8,420,606	\$ 9,081,135	\$ 8,420,606	\$ 9,081,135

*These Condensed Financial Statements should be read in conjunction with the accompanying Notes to Financial Statements included herein.*

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**Table of Contents**

NOTES TO CONDENSED FINANCIAL STATEMENTS (UNAUDITED)

**1. Basis of Presentation**

The condensed financial statements included herein have been prepared without audit, pursuant to the rules and regulations of the Securities and Exchange Commission ( SEC ). These condensed financial statements should be read in conjunction with the financial statements and the notes thereto included in San Juan Basin Royalty Trust (the Trust ) Annual Report on Form 10-K for the year ended December 31, 2015. In the opinion of Compass Bank, the trustee of the Trust (the Trustee ), all adjustments, consisting only of normal recurring adjustments, have been included that are necessary to fairly present the assets, liabilities and trust corpus of the Trust at June 30, 2016 and December 31, 2015 and the distributable income and changes in trust corpus for the three-month periods and the six-month periods ended June 30, 2016 and 2015. The distributable income for such interim periods is not necessarily indicative of the distributable income for the full year.

The financial statements of the Trust are prepared on the following basis and are not intended to present the financial position and results of operations of the Trust in conformity with U.S. generally accepted accounting principles ( GAAP ):

The net proceeds attributable to the 75% net overriding royalty interest (the Royalty ) that burdens certain oil and natural gas interests originally owned by Southland Royalty Company (the Subject Interests ) in properties located in the San Juan Basin of northwestern New Mexico (the Royalty Income ) recorded for a month is the amount computed and paid by Southland s successor, Burlington Resources Oil & Gas Company LP ( Burlington ), which is a wholly-owned subsidiary of ConocoPhillips, to the Trustee for the Trust. Royalty Income consists of the proceeds received by ConocoPhillips from the sale of production 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 ConocoPhillips 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 the holders of units of the Trust ( 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 production costs applicable to the Subject Interests 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 liabilities and 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 trust corpus instead of as an expense. Most accounting pronouncements apply to entities whose

financial statements are prepared in accordance with GAAP, directing such entities to accrue or defer revenues and expenses in a period other than when such revenues were received or expenses were paid. Because the Trust's financial statements are prepared on the modified cash basis, as described above, most accounting pronouncements are not applicable to the Trust's financial statements. This comprehensive basis of accounting corresponds to the accounting permitted for royalty trusts by the SEC, as specified by Staff Accounting Bulletin Topic 12:E, Financial Statements of Royalty Trusts.

The Trustee routinely reviews its royalty interests in oil and natural gas properties for impairment whenever events or circumstances indicate that the carrying amount of an asset may not be recoverable. If an impairment event occurs and it is determined that the carrying value of the Trust's royalty interests may not be recoverable, an impairment will be recognized as measured by the amount by which the carrying amount of the royalty interests exceeds the fair value of these assets, which would likely be measured by discounting projected cash flows. There was no impairment of the assets as of June 30, 2016.



## **Table of Contents**

### **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.

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 natural 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 natural 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 natural 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 natural 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. 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.

Tax positions taken by the Trust related to the Trust's pass-through status and state tax positions have been reviewed, and the Trustee is of the opinion that material positions taken would more likely than not be sustained by examination. As of June 30, 2016, the Trust's tax years 2012 and thereafter remain subject to examination.

**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. COMMITMENTS AND CONTINGENCIES**

Contingencies related to the Subject Interests that are unfavorably resolved would generally be reflected by the Trust as reductions to future Royalty Income payments to the Trust with corresponding reductions to cash distributions to Unit holders. See Note 4 Settlements and Litigation for a discussion of the status of pending litigation matters.

### **4. SETTLEMENTS AND LITIGATION**

On July 31, 2014, the Trustee filed a lawsuit (the 2014 Litigation ) against Burlington in New Mexico State Court. 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. The case is currently scheduled for non-jury trial in March 2017. For more information about the 2014 Litigation, see Part I, Item 3. Legal Proceedings of our Annual Report on Form 10-K for the year ended December 31, 2015.

## **5. CERTAIN CONTRACTS**

Burlington sells natural gas produced from the Subject Interests under various contracts. During the second quarter of 2016, Burlington extended the term of its natural gas sales contract with New Mexico Gas Company, Inc. by two years to March 31, 2019. The contract provides for the sale of certain winter-only natural gas supplies processed at the Kutz plant at prices that fluctuate in accordance with published indices for natural gas sold in the San Juan Basin of northwestern New Mexico. The Trust is not a party to this contract.

## **Table of Contents**

### **6. SUBSEQUENT EVENTS**

The Trustee increased the Trust's cash reserves for payment of contingent and future obligations by \$13,687 from June 30, 2016 to July 29, 2016 to cover Trust expenses in case of a future revenue shortfall due to a prolonged decline in oil and natural gas prices that may reduce Royalty Income.

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

The Trust is an express trust created under the laws of the state of Texas by the San Juan Basin Royalty Trust Indenture entered into on November 1, 1980 between Southland Royalty Company ( "Southland" ) and The Fort Worth National Bank. Effective as of September 30, 2002, the original indenture was amended and restated and, effective as of December 12, 2007, the restated indenture was amended and restated, which we refer to as the "Indenture." As a result of a series of mergers and other transactions, the current Trustee of the Trust is Compass Bank, which is a wholly-owned subsidiary of Banco Bilbao Vizcaya Argentaria, S.A.

### **The Conveyance and the Royalty**

Pursuant to the Net Overriding Royalty Conveyance (the "Conveyance" ) effective November 1, 1980, Southland conveyed to the Trust a 75% net overriding royalty interest (the "Royalty" ) that burdens certain of Southland's oil and natural gas interests (the "Subject Interests" ) in properties located in the San Juan Basin of northwestern New Mexico. Subsequent to the Conveyance of the Royalty, through a series of assignments and mergers, Southland's successor became Burlington Resources Oil & Gas Company LP ( "Burlington" ), which is an indirect wholly-owned subsidiary of ConocoPhillips.

The Royalty constitutes the principal asset of the Trust. The beneficial interest in the Royalty is divided into 46,608,796 units (the "Units" ) representing undivided fractional interests in the beneficial interest of the Trust equal to the number of shares of the common stock of Southland outstanding as of the close of business on November 3, 1980. Each stockholder of Southland 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 then held. Holders of Units are referred to herein as "Unit Holders."

### **The Trustee**

The primary function of the Trustee is to collect Royalty Income, to pay all expenses and charges of the Trust and distribute the remaining available income to the Unit Holders. The amount of income distributable to Unit Holders, which we refer to as "Distributable Income," depends on the amount of Royalty Income and interest received by the Trust, as well as the amount of expenses paid by the Trust and any change in cash reserves. The Trust has no employees, officers or directors. All administrative functions of the Trust are performed by the Trustee.

### **ConocoPhillips**

Affiliates of ConocoPhillips are the principal operators of the majority of the Subject Interests. Burlington 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. A very high percentage of the Royalty Income is attributable to the production and sale by Burlington of natural gas from the Subject Interests. 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.

**Table of Contents****Three and Six Months Ended June 30, 2016 and 2015****Royalty Income**

Royalty Income consists of monthly net proceeds attributable to the Royalty. Royalty Income for the three and six months ended June 30, 2016 and 2015 was determined as shown in the following table:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
<b>Gross proceeds from the Subject Interests:</b>				
Natural Gas	\$ 9,880,817	\$ 17,207,327	\$ 22,608,805	\$ 41,348,942
Oil	435,180	615,064	891,599	1,202,412
Other	(311,050) <sup>(1)</sup>	(3,030) <sup>(2)</sup>	(310,240) <sup>(3)</sup>	(3,030) <sup>(2)</sup>
<b>Total</b>	<b>10,004,947</b>	<b>17,819,361</b>	<b>23,190,164</b>	<b>42,548,324</b>
<b>Production Costs:</b>				
Severance tax gas	1,043,622	1,744,869	2,378,122	4,189,186
Severance tax oil	43,225	61,813	88,677	118,665
Lease operating expense and property tax	6,588,432	7,971,849	13,770,345	15,672,436
Capital expenditures	274,070	5,021,441	852,740	9,755,846
<b>Total</b>	<b>7,949,349</b>	<b>14,799,972</b>	<b>17,089,884</b>	<b>29,736,133</b>
Net profits	2,055,598	3,019,389	6,100,280	12,812,191
Net Overriding Royalty Interest	75%	75%	75%	75%
<b>Royalty Income</b>	<b>\$ 1,541,698</b>	<b>\$ 2,264,542</b>	<b>\$ 4,575,210</b>	<b>\$ 9,609,143</b>

(1) Burlington's revenue adjustment in May for gas revenue reporting for production periods December 2014 – January 2016.

(2) Reversal of Burlington's duplicate payment in March 2015 of interest due on granted and paid audit exceptions.

(3) Includes Burlington's revenue adjustment in May for gas revenue reporting for production periods December 2014 – January 2016 and \$810 additional revenue received in January from the August 2015 settlement of a gas imbalance.

The Royalty Income distributed to the Trust for the three and six months ended June 30, 2016 was lower than that distributed during the same periods of 2015 primarily due to lower natural gas prices offset by higher capital expenditures in 2015. The average natural gas price decreased from \$2.38 per Mcf and \$2.86 per Mcf for the three and six months ended June 30, 2015, respectively, to \$1.43 per Mcf and \$1.61 per Mcf for the three and six month ended June 30, 2016, respectively.

*Gross Proceeds from Subject Interests.* Gross proceeds decreased \$7.8 million or 44% for the three months ended June 30, 2016 compared to the three months ended June 30, 2015 and decreased \$19.3 million or 45% for the six

months ended June 30, 2016 compared to the six months ended June 30, 2015. Such decreases for these periods were primarily attributable to lower natural gas and oil prices along with decreased natural gas volumes.

*Capital Expenditures.* Capital expenditures decreased \$4.7 million or 94% for the three months ended June 30, 2016 compared to the three months ended June 30, 2015 and decreased \$8.9 million or 91% for the six months ended June 30, 2016 compared to the six months ended June 30, 2015. Such decreases for these periods were attributable to maintenance and improvement of production facilities.

*Severance Taxes.* Aggregate severance taxes decreased \$0.7 million or 39% for the three months ended June 30, 2016 compared to the three months ended June 30, 2015 and decreased \$1.8 million or 42% for the six months ended June 30, 2016 compared to the six months ended June 30, 2015. Such decreases were primarily attributable to lower gross proceeds during these periods.

*Lease Operating Expenses and Property Taxes.* Lease operating expenses and property taxes decreased \$1.4 million or 18% for the three months ended June 30, 2016 compared to the three months ended June 30, 2015 and decreased \$1.9 million or 12% for the six months ended June 30, 2016 compared to the six months ended June 30, 2015. Such decreases were primarily attributable to Burlington's efforts to reduce contracted maintenance and repair costs as a result of declining commodity prices. Property taxes increased \$35,551 in the second quarter of 2016 compared to the second quarter of 2015 and \$246,838 in the first half of 2016 compared to the first half of 2015 because actual taxes for 2015 were more than accrued, which resulted in an increase in the current accruals based on a new estimate of ad valorem taxes for 2016.

**Table of Contents**

Monthly lease operating expenses of the Subject Interests, exclusive of property taxes, in second quarter 2016 averaged approximately \$2.2 million, as compared to \$2.6 million in the second quarter of 2015. Monthly lease operating expenses of the Subject Interests, exclusive of property taxes, in the first half of 2016 averaged approximately \$2.2 million, as compared to \$2.6 million in the first half of 2015. Lease operating expenses averaged lower for these periods primarily because of reduced maintenance and repair labor.

**Distributable Income**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Royalty Income	\$ 1,541,698	\$ 2,264,542	\$ 4,575,210	\$ 9,609,143
Interest Income	596	497	1,254	80,444 <sup>(1)</sup>
<b>Total Income</b>	<b>1,542,294</b>	<b>2,265,039</b>	<b>4,576,464</b>	<b>9,689,587</b>
Expenditures General and Administrative	(886,134)	(498,750)	(1,908,570)	(1,160,488)
Increase in Cash Reserves	(225,000)	(350,071)	(450,000)	(350,071)
<b>Distributable Income</b>	<b>431,160</b>	<b>1,416,218</b>	<b>2,217,894</b>	<b>8,179,028</b>
<b>Distributable Income per Unit (46,608,796 Units)</b>	<b>\$ 0.009251</b>	<b>\$ 0.030385</b>	<b>\$ 0.047586</b>	<b>\$ 0.175483</b>

(1) Includes \$78,884 in interest on the late payment of gross proceeds as a result of the ongoing negotiation of compliance audit issues.

*Distributable Income* decreased by approximately \$1.0 million or 71% to \$0.4 million (\$0.009251 per Unit) for the three months ended June 30, 2016 from \$1.4 million (\$0.030385 per Unit) for the three months ended June 30, 2015. Distributable income decreased \$6 million or 73% to \$2.2 million (\$0.047586 per Unit) for the six months ended June 30, 2016 from \$8.2 million (\$0.175483 per Unit) for the six months ended June 30, 2015. Such decreases in Distributable Income were primarily attributable to a decrease in Royalty Income over these periods and increased General and Administrative Expenses directly related to audit and legal costs incurred in the Burlington litigation.

Based on 46,608,796 Units outstanding, the per-Unit distributions during the second quarter of 2016 were as follows:

April	\$ 0.003906
May	0.002649
June	0.002696
<b>Quarter Total</b>	<b>\$ 0.009251</b>

*Interest Income.* Interest income was higher for the three months ended June 30, 2016 as compared to the three months ended June 30, 2015 primarily due to interest earned on the increased cash reserve. Interest income for the six months ended June 30, 2016 were lower as compared to the six months ended June 30, 2015 primarily due to the receipt of \$78,884 in interest on the late payment of gross proceeds in 2015.

*General & Administrative Expenses.* General and administrative expenses increased \$0.4 million or 80% for the three months ended June 30, 2016 compared to the three months ended June 30, 2015 and increased \$0.7 million or 58% for the six months ended June 30, 2016 compared to the six months ended June 30, 2015. Such increases were primarily attributable to increased audit costs and legal costs incurred related to the Burlington litigation.

*Cash Reserves.* Total cash reserves for current Trust expenses were approximately \$1.0 million as of June 30, 2016 compared to \$0.8 million as of March 31, 2016. Cash reserves were increased by \$225,000 during the second quarter of 2016 in order to cover expenses in case of a future revenue shortfall resulting from lower commodity prices.

Total cash reserves were approximately \$0.5 million as of December 31, 2015 and were increased by \$450,000 during the first six months of 2016 in order to cover expenses in case of a future revenue shortfall resulting from lower commodity prices.

### **Liquidity and Capital Resources**

The Trust's principal source of liquidity and capital is Royalty Income. The Trust's distribution of income to Unit Holders is funded by Royalty Income after payment of Trust expenses. The Trust is not liable for any production



**Table of Contents**

costs or liabilities attributable to the Royalty. If at any time the Trust receives more than the amount due under the Royalty, it is not obligated to return such overpayment, but the amounts payable to it for any subsequent period are reduced by such amount, plus interest, at a rate specified in the Conveyance. If the Trustee determines that the Trust does not have sufficient funds to pay its liabilities, the Trustee may borrow funds on behalf of the Trust, in which case no distributions will be made to Unit Holders until such borrowings are repaid in full. The Trustee may not sell or dispose of any part of the assets of the Trust without the affirmative vote the Unit Holders of 75% of all of the Units outstanding; however, the Trustee may sell up to 1% of the value of the Royalty (as determined pursuant to the Indenture) during any 12-month period without the consent of the Unit Holders.

**2016 Capital Expenditures**

ConocoPhillips announced 2016 capital plan for the Subject Interests anticipates capital expenditures of \$4.8 million, of which \$3.4 million is allocated to 20 facilities projects and \$1.4 million is allocated to 20 facilities projects attributable to the budgets for prior years. ConocoPhillips 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 2016 are subject to change.

Primarily due to depressed pricing for natural gas, ConocoPhillips has not allocated any capital expenditures for 2016 to its drilling program in the San Juan Basin. However, ConocoPhillips reported that it continually monitors natural gas prices and plans to restart the program at some point in the future, dependent upon such natural gas prices. Existing wells will continue to be operated.

ConocoPhillips has reported to the Trustee that there was no well activity during the first and second quarters of 2016. During the first quarter of 2015, eight gross (4.8 net) conventional wells were completed on the properties underlying the Subject Interests. During the second quarter of 2015, one gross (1.0 net) conventional well was completed on the properties underlying the Subject Interests.

**Oil and Natural Gas Production**

Royalty Income for the quarter ended June 30, 2016 is associated with actual oil and natural gas production during February 2016 through April 2016 from the Subject Interests. Royalty income for the six months ended June 30, 2015 is associated with actual gas and oil production during November 2015 through April 2016 from the Subject Interests.

Production of oil and natural gas and related average sales prices attributable to each of the Subject Interests and the Royalty for the three months ended June 30, 2016 and 2015, were as follows:

	<b>For the Three Months Ended June 30,</b>			
	<b>2016</b>		<b>2015</b>	
	Natural Gas (Mcf)	Oil and Condensate (Bbls)	Natural Gas (Mcf)	Oil and Condensate (Bbls)
<b>Production</b>				
Subject Interests	6,914,622	18,654	7,238,541	16,533
Royalty	1,327,550	3,658	1,052,961	2,811
Average Price (per Mcf/Bbl)	\$ 1.43	\$ 23.33	\$ 2.38	\$ 37.20

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Production of oil and natural gas and related average sales prices attributable to each of the Subject Interests and the Royalty for the six months ended June 30, 2016 and 2015, were as follows:

	<b>For the Six Months Ended June 30,</b>		<b>2015</b>	
	<b>2016</b>			<b>2015</b>
	Natural Gas (Mcf)	Oil and Condensate (Bbls)	Natural Gas (Mcf)	Oil and Condensate (Bbls)
<b>Production</b>				
Subject Interests	14,001,972	35,225	14,438,245	28,890
Royalty				