

SAN JUAN BASIN ROYALTY TRUST  
Form 10-Q  
November 10, 2008

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q**

**Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the Quarterly Period Ended September 30, 2008**

or

**Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File No. 1-8032**

**SAN JUAN BASIN ROYALTY TRUST**

(Exact name of registrant as specified in the

Amended and Restated San Juan Basin Royalty Trust Indenture)

Texas  
(State or other jurisdiction  
of incorporation or organization)

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

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

(Zip Code)

(866) 809-4553

(Registrant's telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

(Do not check if a smaller reporting company)

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

Number of Units of beneficial interest outstanding at November 10, 2008: 46,608,796

**SAN JUAN BASIN ROYALTY TRUST**  
**PART I**  
**FINANCIAL INFORMATION**

**Item 1. Financial Statements.**

The condensed financial statements included herein have been prepared without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. In accordance with Securities and Exchange Commission Staff Accounting Bulletin No. 47, released September 16, 1982, the financial statements of the San Juan Basin Royalty Trust (the Trust ) continue to be prepared in a manner that differs from generally accepted accounting principles in the United States of America ( GAAP ); this form of presentation is customary to other royalty trusts. Certain information and footnote disclosures normally included in annual financial statements have been condensed or omitted pursuant to Rule 10-01 of Regulation S-X promulgated under the Securities Exchange Act of 1934. Nonetheless, Compass Bank, the Trustee of the Trust, believes that the disclosures are adequate to make the information presented not misleading. These condensed financial statements should be read in conjunction with the financial statements and the notes thereto included in the Trust s Annual Report on Form 10-K for the year ended December 31, 2007. In the opinion of the Trustee, all adjustments, consisting only of normal recurring adjustments, have been included that are necessary to fairly present the assets, liabilities and trust corpus of the Trust at September 30, 2008 and the distributable income and changes in trust corpus for the three-month periods and nine-month periods ended September 30, 2008 and 2007. The distributable income for such interim periods is not necessarily indicative of the distributable income for the full year.

**SAN JUAN BASIN ROYALTY TRUST**  
**CONDENSED STATEMENTS OF ASSETS, LIABILITIES AND TRUST CORPUS**

	<b>September 30, 2008 (Unaudited)</b>	<b>December 31, 2007</b>
<b>ASSETS</b>		
Cash and short-term investments	\$ 21,133,743	\$ 9,042,528
Net overriding royalty interest in producing oil and gas properties (net of accumulated amortization of \$114,843,066 and \$111,452,138 at September 30, 2008 and December 31, 2006, respectively)	18,432,462	19,880,888
	\$ 39,566,205	\$ 28,923,416
<b>LIABILITIES AND TRUST CORPUS</b>		
Distribution payable to Unit Holders	\$ 20,977,954	\$ 8,927,670
Cash reserves	155,789	114,858
Trust corpus 46,608,796 Units of beneficial interest authorized and outstanding	18,432,462	19,880,888
	\$ 39,566,205	\$ 28,923,416

**CONDENSED STATEMENTS OF DISTRIBUTABLE INCOME (UNAUDITED)**

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Royalty income	\$ 52,541,763	\$ 37,086,982	\$ 113,730,327	\$ 87,324,045
Interest income	32,508	561,866	216,621	1,275,679
Total Revenue	52,574,271	37,648,848	113,946,948	88,599,724
General and administrative expenditures	351,221	263,629	1,554,074	1,411,072
Distributable income	\$ 52,223,050	\$ 37,385,219	\$ 112,392,874	\$ 87,188,652
Distributable income per Unit (46,608,796 Units)	\$ 1.120455	\$ .802107	\$ 2.411409	\$ 1.870650

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

**SAN JUAN BASIN ROYALTY TRUST  
CONDENSED STATEMENTS OF CHANGES IN TRUST CORPUS (UNAUDITED)**

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Trust corpus, beginning of period	\$ 18,975,921	\$ 21,004,120	\$ 19,880,888	\$ 21,823,390
Amortization of net overriding royalty interest	(543,459)	(605,548)	(1,448,426)	(1,424,818)
Distributable income	52,223,050	37,385,219	112,392,874	87,188,652
Distributions declared	(52,223,050)	(37,385,219)	(112,392,874)	(87,188,652)
Trust corpus, end of period	18,432,462	20,398,572	18,432,462	20,398,572

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

**SAN JUAN BASIN ROYALTY TRUST**  
**NOTES TO CONDENSED FINANCIAL STATEMENTS (UNAUDITED)**

**1. BASIS OF ACCOUNTING**

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

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

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

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

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

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

**2. FEDERAL INCOME TAXES**

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

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

The Royalty constitutes an economic interest in oil and gas properties for federal income tax purposes. Unit Holders must report their share of the revenues of the Trust as ordinary income from oil and gas royalties and are entitled to claim depletion with respect to such income. The Royalty is treated as a single property for depletion purposes. The Trust has on file technical advice memoranda confirming such tax treatment.

Sales of gas production from certain coal seam wells drilled prior to January 1, 1993 qualified for federal income tax credits under Section 29 (now Section 45K) of the Internal Revenue Code of 1986 (as amended, the Code) through 2002, but not thereafter. Accordingly, under present law, the Trust's production and sale of gas from coal seam wells does not qualify for tax credit under Section 45K of the Code (the Section 45K Tax Credit). Congress has at various times since 2002 considered energy legislation, including provisions to reinstate the Section 45K Tax Credit in various ways and to various extents, but no legislation that would qualify the Trust's current production for such credit has been enacted. For example, on August 8, 2005, new energy tax legislation was enacted which, among other things, modified the Section 45K Tax Credit in several respects, but did not extend the credit for production from coal seam wells. No prediction can be made as to what future tax legislation affecting Section 45K of the Code may be proposed or enacted or, if enacted, its impact on the Trust and the Unit Holders.

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

### **3. CONTINGENCIES**

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

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

As a result of the ongoing joint interest audit process, an aggregate of \$128,827 was paid to the Trust by BROG during the first nine months of 2008, as interest on the late payment of gross proceeds. All of this amount was paid during the first quarter of 2008.

During the third quarter of 2007, as part of the negotiations between the Trust and BROG concerning a number of revenue and expense items, a reduction of \$33,472 in operating expenses was included in calculating net proceeds paid to the Trust, together with interest of \$493,173. BROG paid an aggregate of \$1,110,574 to the Trust during the first nine months of 2007, as interest on the late payment of gross proceeds.

On April 28, 2008, the Trust filed a suit against BROG relating to the Arbitration Award in its favor issued in November 2005, in the amount of \$7,683,699. The litigation is 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 alleges breach of contract and breach of the covenant of good faith and fair dealing and seeks 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 joint interest 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. The appellate court also remanded the case to the District Court, where BROG is pursuing its claim for attorneys' fees and costs in the amount of approximately \$200,000. On September 8, 2008, BROG filed a motion for summary judgment. The Trust has filed its response opposing that motion and its own cross-motion for summary judgment, and a hearing on the motions is currently set for November 10, 2008.

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 seeks recovery on the claim which had been resolved in favor of the Trust by the arbitrator.

In June 2008, BROG removed the Trust's state court suit to the federal court in New Mexico and filed a motion seeking to have the case transferred to the federal district court in Houston. BROG's action in the federal court is styled San Juan Basin Royalty Trust v. Burlington Resources Oil & Gas Company LP, No. 08cv532WJ/ACT, in the United States District Court for the District of New Mexico. In July 2008, the Trust filed a motion to remand the case from the federal to the state court in New Mexico together with a response in opposition to BROG's motion to change the venue of the case to Houston, Texas. The jurisdictional and venue issues raised by BROG will be decided, with or without a hearing, by the U.S. District Court in Albuquerque.

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

**Forward-Looking Information**

Certain information included in this Quarterly Report on Form 10-Q contains, and other materials filed or to be filed by the Trust with the Securities and Exchange Commission (as well as information included in oral statements or other written statements made or to be made by the Trust) may contain or include, forward-looking statements 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, plan, intend, or other words that convey the uncertainty of future events or outcomes. Such statements reflect the current view of Burlington Resources Oil & Gas Company LP ( BROG ) with respect to future events; are based on an assessment of, and are subject to, a variety of factors deemed relevant by the Trustee and BROG; and involve risks and uncertainties. These risks and uncertainties include volatility of oil and gas prices, product supply and demand, competition, regulation or government action, litigation and uncertainties about estimates of reserves. Should one or more of these risks or uncertainties occur, actual results may vary materially and adversely from those anticipated.

**Business Overview**

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

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 ( BBVA ) and is now a wholly-owned subsidiary of BBVA.

The Royalty constitutes the principal asset of the Trust and the beneficial interests in the Trust 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. 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 income attributable to the Royalty, pay all expenses and charges of the Trust, and 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.

### Three Months Ended September 30, 2008 and 2007

The Trust received Royalty income of \$52,541,763 and interest income of \$32,508 during the third quarter of 2008. The Trust recovered \$40,930 previously escheated to the State of Texas in the name of the Trust, and those funds were added to cash reserves pending further research as to the origin of the funds. After deducting administrative expenses of \$351,221, distributable income for the quarter was \$52,223,050 (\$1.120455 per Unit). In the third quarter of 2007, Royalty income was \$37,086,982, interest income was \$561,866, there was no change in cash reserves, administrative expenses were \$263,629 and distributable income was \$37,385,219 (\$0.802107 per Unit). Based on 46,608,796 Units outstanding, the per-Unit distributions during the third quarter of 2008 were as follows:

July	\$ .321518
August	.348851
September	.450086
 Quarter Total	 \$ 1.120455

The Royalty income distributed in the third quarter of 2008 was higher than that distributed in the third quarter of 2007. The average gas price increased from \$6.55 per Mcf for the third quarter of 2007 to \$10.62 per Mcf for the third quarter of 2008. However, gas volumes decreased in the quarter ended September 30, 2008 as compared to the quarter ended September 30, 2007. BROG has informed the Trust that the decrease in reported volumes was due primarily to the natural production decline curve. Interest income was lower for the quarter ended September 30, 2008 as compared to the quarter ended September 30, 2007, primarily due to additional interest BROG paid to the Trust in the third quarter of 2007 as a result of the granting of certain audit exceptions, and also due to higher interest rates in the third quarter of 2007. Administrative expenses were higher in 2008 primarily as a result of differences in timing in the receipt and payment of these expenses, but also due to an increase in legal expenses incurred in the litigation between BROG and the Trust described in Part II, Item I, below.

The capital costs attributable to the Underlying Properties for the third quarter of 2008 and deducted by BROG in calculating Royalty income were approximately \$7.5 million. BROG has informed the Trust that the 2008 budget for capital expenditures for the Underlying Properties is \$24.4 million. 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.

BROG has informed the Trust that lease operating expenses and property taxes were \$7,947,438 and \$276,732, respectively, for the third quarter of 2008, as compared to \$7,209,240 and \$229,547, respectively, for the third quarter of 2007. BROG reports that lease operating expenses were higher in the third quarter of 2008 compared to the third quarter of 2007 primarily due to demand-related increases in the cost of contract services and materials. New drilling results in increases in salt water disposal and compression costs. Additionally, the overhead rate determined by the Council of Petroleum Accountants Societies was adjusted in April 2008 to 7.7%, from the previous rate of 6.4%.

BROG has reported to the Trustee that during the third quarter of 2008, two gross (0.86 net) coal seam wells and 11 gross (0.13 net) conventional wells were completed on the Underlying Properties. Two gross (0.002 net) coal seam wells and four gross (1.09 net) conventional wells were in progress at September 30, 2008.

There were 17 gross (0.19 net) conventional wells completed on the Underlying Properties and eight gross (0.13 net) conventional wells and six gross (2.99 net) coal seam wells were in progress at September 30, 2007.

There were 3,823 gross (1,111 net) producing wells being operated subject to the Royalty as of December 31, 2007, calculated on a well bore basis and not including multiple completions as separate wells. Unit Holders will be provided a copy of the current well list upon written request to the Trustee.

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 September 30, 2008 is associated with actual gas and oil production during May 2008 through July 2008 from the Underlying Properties. Gas and oil sales from the Underlying Properties for the three months ended September 30, 2008 and 2007 were as follows:

	<b>Three Months Ended September 30,</b>	
	<b>2008</b>	<b>2007</b>
<b>Gas:</b>		
Total sales (Mcf)	8,737,027	9,954,324
Mcf per day	94,968	108,199
Average price (per Mcf)	\$ 10.62	\$ 6.55
<b>Oil:</b>		
Total sales (Bbls)	12,793	16,936
Bbls per day	139	184
Average price (per Bbl)	\$ 120.99	\$ 64.16

Gas and oil sales attributable to the Royalty for the quarters ended September 30, 2008 and 2007 were as follows:

	<b>Three Months Ended September 30,</b>	
	<b>2008</b>	<b>2007</b>
Gas sales (Mcf)	5,326,507	6,117,289
Oil sales (Bbls)	7,724	10,379

Sales volumes attributable to the Royalty are determined by dividing the net profits received by the Trust and attributable to oil and gas, respectively, by the prices received for sales volumes from the Underlying Properties, taking into consideration production taxes attributable to the Underlying Properties. Since the oil and gas sales attributable to the Royalty are based on an allocation formula that is dependent on such factors as price and cost, including capital expenditures, the aggregate production volumes from the Underlying Properties may not provide a meaningful comparison to volumes attributable to the Royalty.

During the third quarter of 2008, average gas prices were \$4.07 per Mcf higher than the average prices reported during the third quarter of 2007. The average price per barrel of oil during the third quarter of 2008 was \$56.83 per barrel higher than that received for the third quarter of 2007 due to increases in oil prices in world markets generally, including the posted prices applicable to oil sales attributable to the Royalty.

BROG previously entered into three contracts for the sale of all volumes of gas produced from the Underlying Properties to ChevronTexaco Natural Gas, a division of Chevron U.S.A. Inc. ( ChevronTexaco ), Coral Energy Resources, L.P. ( Coral ), and PNM Gas Services ( PNM ), respectively. All three contracts provide for (i) 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 (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 2008, both ChevronTexaco and Coral notified BROG of their election to terminate their respective contracts effective March 31, 2009. Requests for proposal will be circulated to potential purchasers of the packages of gas covered by the

expiring contracts. Neither BROG nor PNM gave notice of termination with respect to the PNM contract and, accordingly, the term of that contract has been extended at least through March 31, 2010.

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.

**Nine Months Ended September 30, 2008 and 2007**

For the nine months ended September 30, 2008, the Trust received Royalty income of \$113,730,327 and interest income of \$216,621. In August, the Trust recovered \$40,930 previously escheated to the State of Texas in the name of the Trust, and those funds were added to cash reserves pending further research as to the origin of the funds. After deducting administrative expenses of \$1,554,074, distributable income was \$112,392,874 (\$2.411409 per Unit) for the nine months ended September 30, 2008. For the nine months ended September 30, 2007, the Trust received Royalty income of \$87,324,045 and interest income of \$1,275,679. There was no change in cash reserves. After deducting administrative expenses of \$1,411,072, distributable income was \$87,188,652 (\$1.870650 per Unit) for the nine months ended September 30, 2007.

The increase in distributable income from 2007 to 2008 resulted primarily from higher gas prices during the first nine months of 2008. However, gas volumes decreased in the nine months ended September 30, 2008, primarily due to the natural production decline curve and, in part, to unplanned down-time at a facility operated by a third party. Interest earnings were lower for the nine months ended September 30, 2008 as compared to the nine months ended September 30, 2007, primarily due to interest paid to the Trust in 2007 in settlement of audit issues relating to the late payment of gross proceeds, and also due to higher interest rates in the third quarter of 2007. General and administrative expenses were higher for the nine months ended September 30, 2008, as compared to the same period in 2007, primarily as a result of differences in timing in the receipt and payment of the expenses, but also due to an increase in legal expenses incurred in the litigation between BROG and the Trust described in Part II, Item I, below.

Capital expenditures incurred by BROG, attributable to the Underlying Properties, for the first nine months of 2008 amounted to approximately \$19.9 million. Capital expenditures were approximately \$22.3 million for the first nine months of 2007. Lease operating expenses and property taxes first nine months of 2008 totaled \$23,767,528 and \$798,760, respectively, as compared to \$20,821,161 and \$781,302, respectively, for 2007.

BROG has reported to the Trustee that during the nine months ended September 30, 2008, 20 gross (8.52 net) coal seam wells and 59 gross (2.42 net) conventional wells were completed on the Underlying Properties. There were 18 gross (9.84 net) coal seam wells and 38 gross (8.07 net) conventional wells completed on the Underlying Properties during the nine months ended September 30, 2007.

Royalty income for the nine months ended September 30, 2008 is associated with actual gas and oil production during November 2007 through July 2008 from the Underlying Properties. Gas and oil sales from the Underlying Properties for the nine months ended September 30, 2008 and 2007 were as follows:

	<b>Nine Months Ended September 30,</b>	
	<b>2008</b>	<b>2007</b>
<b>Gas:</b>		
Total sales (Mcf)	25,133,676	27,533,964
Mcf per day	91,729	100,857
Average price (per Mcf)	\$ 8.72	\$ 6.33
<b>Oil:</b>		
Total Sales (Bbls)	36,168	51,172
Bbls per day	132	187
Average price (per Bbl)	\$ 101.88	\$ 58.87

Gas and oil sales attributable to the Royalty for the nine months ended September 30, 2008 and 2007 were as follows:

	<b>Nine Months Ended September 30,</b>	
	<b>2008</b>	<b>2007</b>
Gas sales (Mcf)	14,579,826	14,887,130
Oil sales (Bbls)	20,787	27,074

During the first nine months of 2008 gas and oil prices were higher than during the first nine months of 2007. Since the oil and gas sales attributable to the Royalty are based on an allocation formula that is dependant on such factors as price and cost, including capital expenditures, the aggregate sales amounts from the Underlying Properties may not provide a meaningful comparison to sales attributable to the Royalty.

On March 14, 2008, BROG notified the Trust that the distribution for March would be reduced by \$4,921,578, an amount described in the notice as the Trust's portion of what BROG had paid to settle a legal matter. On March 16, 2008, following inquiry from the Trust, BROG reported that on August 15, 2007 it reached an agreement settling all claims asserted by the United States of America, acting through the Department of Justice and the United States Department of the Interior, itself acting through the Minerals Management Service and the Bureau of Indian Affairs on behalf of itself and on behalf of various individual Native American mineral owners, the Cheyenne and Arapaho Tribes, the Jicarilla Apache Tribe, the Southern Ute Tribe, and the Ute Mountain Ute Tribe in the United States District Court for the Eastern District of Texas, captioned United States of America ex rel. Harrold E. ( Gene ) Wright v. AGIP Petroleum Co. et al., Civil Action No. 5:03CV264 (formerly 9:98-CV-30) (E.D. Tex.). BROG, on behalf of itself and the Trust, paid \$105,304,226 to settle claims for underpayment of royalty alleged to be owed on natural gas production, including production from properties burdened by the Trust, for production periods between March 1, 1988 and March 31, 2005.

BROG determined that the portion of that settlement allocable to the Trust was \$6,078,917 in principal, together with \$486,187 of interest, totaling \$6,562,104. That amount was offset against the

revenues used in calculating net profits for the month of March and the royalty distribution was calculated based on the Trust's 75% net overriding royalty interest which resulted in the \$4,921,578 reduction in the March distribution. BROG indicated that the portion allocated to the Trust was determined by it based upon a comparison of the properties burdened by the Trust in proportion to all of the properties associated with the litigation settlement. The Trust's consultants will analyze the settlement and audit the calculation of the amount determined by BROG to be allocable to the Trust.

### Calculation of Royalty Income

Royalty income received by the Trust for the three months and nine months ended September 30, 2008 and 2007, respectively, was computed as shown in the following table:

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Gross proceeds of sales from the Underlying Properties:				
Gas proceeds	\$ 92,813,502	\$ 65,197,892	\$ 212,607,028 <sup>(1)</sup>	\$ 174,231,856
Oil proceeds	1,547,800	1,086,618	3,684,910	3,012,266
Other	0	0	0	45,066 <sup>(2)</sup>
 Total	 94,361,302	 66,284,510	 216,291,938	 177,289,188
 Less production costs:				
Severance tax - gas	8,391,694	6,085,096	19,856,326	16,615,175
Severance tax - oil	152,033	109,607	369,512	291,005
Lease operating expense and property tax	8,224,170	7,438,787	24,566,288	21,602,463
Capital expenditures	7,537,721	3,201,710	19,859,376	22,348,485
 Total	 24,305,618	 16,835,200	 64,651,502	 60,857,128
 Net profits	 70,055,684	 49,449,310	 151,640,436	 116,432,060
Net overriding royalty interest	75%	75%	75%	75%
 Royalty income	 \$ 52,541,763	 \$ 37,086,982	 \$ 113,730,327	 \$ 87,324,045

(1) In March, 2008, gas proceeds were reduced by \$6,562,104 as the amount BROG determined to be the Trust's

portion of  
BROG s  
settlement of a  
legal matter  
with the MMS  
and the Bureau  
of Indian  
Affairs.

- (2) In May, 2007,  
as part of the  
ongoing  
negotiations  
between the  
Trust and  
BROG  
concerning a  
number of  
revenue and  
expense audit  
issues, \$45,066  
was allocated to  
the Trust as  
additional  
revenue.

**Contractual Obligations**

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

### **Effects of Securities Regulation**

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

### **Critical Accounting Policies**

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

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

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

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

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

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

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

The Trust invests in no derivative financial instruments, and has no foreign operations or long-term debt instruments. The Trust is a passive entity and is prohibited from engaging in a trade or



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

**Item 4. Controls and Procedures.**

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

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

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

The Trustee has evaluated the Trust's disclosure controls and procedures as of September 30, 2008 and has concluded that such disclosure controls and procedures are effective, at the reasonable assurance level, to ensure that material information related to the Trust is gathered on a timely basis to be included in the Trust's periodic reports. In reaching its conclusion, the Trustee has considered the Trust's dependence on BROG to deliver timely and accurate information to the Trust. Additionally, during the quarter ended September 30, 2008 there were no changes in the Trust's internal control over financial reporting (as defined in Rule 13a-15(f) of the Securities Exchange Act of 1934) that materially affected, or are reasonably likely to materially affect, the Trust's internal control over financial reporting. The Trustee has reviewed neither the Trust's disclosure controls and procedures nor the Trust's internal control over financial reporting in concert with management, a board of directors or an independent audit committee. The Trust does not have, nor does the Indenture provide for, officers, a board of directors or an independent audit committee.

**PART II**  
**OTHER INFORMATION**

**Item 1. Legal Proceedings.**

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

On April 28, 2008, the Trust filed a suit against BROG relating to the Arbitration Award in its favor issued in November 2005, in the amount of \$7,683,699. The litigation is 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 alleges breach of contract and breach of the covenant of good faith and fair dealing and seeks 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 joint interest 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. The appellate court also remanded the case to the District Court, where BROG is pursuing its claim for attorneys' fees and costs in the amount of approximately \$200,000. On September 8, 2008, BROG filed a motion for summary judgment. The Trust has filed its response opposing that motion and its own cross-motion for summary judgment, and a hearing on the motions is currently set for November 10, 2008.

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 seeks recovery on the claim which had been resolved in favor of the Trust by the arbitrator.

In June 2008, BROG removed the Trust's state court suit to the federal court in New Mexico and filed a motion seeking to have the case transferred to the federal district court in Houston. BROG's action in the federal court is styled San Juan Basin Royalty Trust v. Burlington Resources Oil & Gas Company LP, No. 08cv532WJ/ACT, in the United States District Court for the District of New Mexico. In July 2008, the Trust filed a motion to remand the case from the federal to the state court in New Mexico together with a response in opposition to BROG's motion to change the venue of the case to Houston, Texas. The jurisdictional and venue issues raised by BROG will be decided, with or without a hearing, by the U.S. District Court in Albuquerque.

BROG has informed the Trust that pursuant to an Order to Perform (the MMS Order) issued by the Minerals Management Service (MMS) dated June 10, 1998, the Jicarilla Apache Nation (the Jicarilla) alleged that in valuing production for royalty purposes one must perform (i) a major portion analysis, which calculates value on the highest price paid or offered for a major portion of the gas produced from the field where the leased lands are situated; and (ii) a dual accounting calculation, which

computes royalties on the greater of (a) the value of gas prior to processing or (b) the combined value of processed residue gas and plant products plus the value of any condensate recovered downstream without processing. The MMS Order alleged that BROG's dual accounting calculations on Native American leases were based on less than major portion prices. In December 2000, BROG and the Jicarilla entered into a settlement agreement resolving the issues associated with the dual accounting calculation. The major portion calculation issue remains outstanding. A judgment or settlement could entitle BROG to reimbursement from the Trust for past periods.

According to BROG, on March 28, 2007 the Assistant Secretary of Indian Affairs of the United States Department of Interior issued an administrative order in BROG's appeal of the major portion calculation issue of the MMS Order entitled MMS-98-0141-IND Burlington Resources Oil & Gas Company LP (the Administrative Order). The administrative order rejected that portion of the MMS Order requiring BROG to calculate and pay additional royalties based on the major portion price derived by the MMS. In May 2007, rather than file a direct appeal of the Administrative Order against BROG, the Jicarilla filed suit solely against the Department of Interior in the United States District Court for the District of Columbia in an action entitled 1:07-CV-00803-RJL, Jicarilla Apache Nation v. Department of Interior (the DOI Case). In the DOI Case, the Jicarilla seek a declaration that the Administrative Order is unlawful and of no force and effect, as well as an injunction requiring enforcement of the rejected major portion element of the MMS Order. While a judgment or settlement in the DOI Case could impact the Royalty income of the Trust, the Trust has not, at this time, received any report from BROG as to the status of the DOI Case, or any estimate of the amount of any potential loss or the portion of any such potential loss that might be allocated to the Royalty.

In addition to the litigation described above, BROG is involved in various legal proceedings, the outcome of which may impact the Trust. Should certain legal proceedings to which BROG is a party be decided in a manner adverse to BROG, the amount of Royalty income received by the Trust could materially decrease. The Trust has not received from BROG any estimate of the amount of any potential loss in such proceedings, or the portion of any such potential loss that might be allocated to the Royalty.

**Item 6. Exhibits.**

- (4)(a) Amended and Restated Royalty Trust Indenture, dated September 30, 2002 (the original Royalty Trust Indenture, dated November 1, 1980, having been entered into between Southland Royalty Company and The Fort Worth National Bank, as Trustee), heretofore filed as Exhibit 99.2 to the Trust's Current Report on Form 8-K filed with the Commission on October 1, 2002, is incorporated herein by reference.\*
  - (4)(b) Net Overriding Royalty Conveyance from Southland Royalty Company to the Fort Worth National Bank, as Trustee, dated November 3, 1980 (without Schedules), heretofore filed as Exhibit 4(b) to the Trust's Annual Report on Form 10-K filed with the Commission for the fiscal year ended December 31, 2007, is incorporated herein by reference.\*
  - (4)(c) Assignment of Net Overriding Interest (San Juan Basin Royalty Trust), dated September 30, 2002, between Bank One, N.A. and TexasBank, heretofore filed as Exhibit 4(c) to the Trust's Quarterly Report on Form 10-Q filed with the Commission for the quarter ended September 30, 2002, is incorporated herein by reference.\*
- 31 Certification required by Rule 13a-14(a), dated November 10, 2008, by Lee Ann Anderson, Vice President and Senior Trust Officer of Compass Bank, the Trustee of the Trust.\*\*

32 Certification required by Rule 13a-14(b), dated November 10, 2008, by Lee Ann Anderson, Vice President and Senior Trust Officer of Compass Bank, on behalf of Compass Bank, the Trustee of the Trust.\*\*\*

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

\*\* Filed herewith.

\*\*\* Furnished herewith.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

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

By: /s/ Lee Ann Anderson  
Lee Ann Anderson  
Vice President and Senior Trust Officer

Date: November 10, 2008

(The Trust has no directors or executive officers.)

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**INDEX TO EXHIBITS**

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