

SAN JUAN BASIN ROYALTY TRUST

Form 10-Q

August 06, 2010

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

Form 10-Q

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934
For the Quarterly Period Ended June 30, 2010**

or

o **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 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

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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 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 August 6, 2010: 46,608,796

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SAN JUAN BASIN ROYALTY TRUST

**PART I
FINANCIAL INFORMATION**

Item 1. *Financial Statements.*

The condensed financial statements included herein have been prepared without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. The financial statements of the San Juan Basin Royalty Trust (the Trust) continue to be prepared in a manner that differs from generally accepted accounting principles in the United States of America (GAAP); this form of presentation is customary to other royalty trusts. Certain information and footnote disclosures normally included in annual financial statements have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. Nonetheless, Compass Bank, the trustee of the Trust (the Trustee), believes that the disclosures are adequate to make the information presented not misleading. These condensed financial statements should be read in conjunction with the financial statements and the notes thereto included in the Trust s Annual Report on Form 10-K for the year ended December 31, 2009. 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 June 30, 2010 and the distributable income and changes in trust corpus for the three-month periods and six-month periods ended June 30, 2010 and 2009. The distributable income for such interim periods is not necessarily indicative of the distributable income for the full year.

Table of Contents**CONDENSED STATEMENTS OF ASSETS, LIABILITIES AND TRUST CORPUS**

	June 30, 2010 (Unaudited)	December 31, 2009
ASSETS		
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,		Six Months Ended June 30,	
	2010	2009	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 the 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		Six Months Ended	
	June 30,		June 30,	
	2010	2009	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

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

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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.

In preparing the condensed interim financial statements, the Trust has evaluated, for potential recognition or disclosure, events or transactions subsequent to the end of the most recent quarterly period through the issuance date of these condensed interim financial statements. No such transactions or events resulted in additional recognition or disclosure.

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

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that will provide tax information in accordance with the applicable U.S. Treasury Regulations governing the information reporting requirements of the Trust as a WHFIT and a NMWHFIT.

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

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NOTES TO CONDENSED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

Sales of gas production from certain coal seam wells drilled prior to January 1, 1993, qualified for federal income tax credits under Section 29 (now Section 45K) of the Internal Revenue Code of 1986 (as amended, the Code) through 2002 but not thereafter. Accordingly, under present law, the Trust's production and sale of gas from coal seam wells does not qualify for tax credit under Section 45K of the Code (the Section 45 Tax Credit). Congress has at various times since 2002 considered energy legislation, including provisions to reinstate the Section 45 Tax Credit in various ways and to various extents, but no legislation that would qualify the Trust's current production for such credit has been enacted. For example, in February 2009, new energy tax legislation was enacted which, among other things, modified the Section 45 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, if any, on the Trust and the Unit Holders. 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.

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

3. CONTINGENCIES

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

4. SETTLEMENTS AND LITIGATION

On March 14, 2008, BROG notified the Trust that the distribution for March would be reduced by \$4,921,578. BROG described this amount as the Trust's portion of what BROG had paid to settle claims for the underpayment of royalties in the case styled United States of America ex rel. Harrold E. (Gene) Wright v. AGIP Petroleum Co. et al., Civil Action No. 5:03CV264 (formerly 9:98-CV-30) (E.D. Tex.). The Trust's consultants continue to analyze this settlement as it may apply to the Trust.

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

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NOTES TO CONDENSED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

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 agreed 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.

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

Forward-Looking Information

Certain information included in this Quarterly Report on Form 10-Q contains, and other materials filed or to be filed by the Trust with the Securities and Exchange Commission (as well as information included in oral statements or other written statements made or to be made by the Trust) may contain or include, forward-looking statements. Such forward-looking statements may be or may concern, among other things, capital expenditures, drilling activity, development activities, production efforts and volumes, hydrocarbon prices, estimated future net revenues, estimates of reserves, the results of the Trust's activities, and regulatory matters. Such forward-looking statements generally are accompanied by words such as may, will, estimate, expect, predict, project, anticipate, goal, should, plan, intend, or other words that convey the uncertainty of future events or outcomes. Such statements reflect the current view of Burlington Resources Oil & Gas Company LP (BROG), the working interest owner, with respect to future events; are based on an assessment of, and are subject to, a variety of factors deemed relevant by the Trustee and 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 First Restated Indenture) and, effective as of December 12, 2007 the First Restated Indenture was amended and restated (the First Restated Indenture, as amended and restated, the Indenture). The Trustee of the Trust is Compass Bank.

On October 23, 1980, the stockholders of Southland Royalty approved and authorized that company's conveyance of a 75% net overriding royalty interest (equivalent to a net profits interest) to the Trust for the benefit of the stockholders of Southland Royalty of record at the close of business on the date of the conveyance (the Royalty) carved out of that company's oil and gas leasehold and royalty interests (the Underlying Properties) in properties located in the San Juan Basin of northwestern New Mexico. Pursuant to the Net Overriding Royalty Conveyance (the Conveyance) the Royalty was transferred to the Trust on November 3, 1980 effective as to production from and after November 1, 1980 at 7:00 a.m.

The Royalty constitutes the principal asset of the Trust. The beneficial interests in the Royalty are divided into that number of Units of Beneficial Interest (the Units) of the Trust equal to the number of shares of the common stock of Southland Royalty outstanding as of the close of business on November 3, 1980. Each stockholder of Southland Royalty of record at the close of business on November 3, 1980 received one freely tradable Unit for each share of the common stock of Southland Royalty then held. Holders of Units are referred to herein as Unit Holders. Subsequent to the Conveyance of the Royalty, through a series of assignments and mergers, Southland Royalty's successor became BROG. On March 31, 2006, a subsidiary of ConocoPhillips completed its acquisition of Burlington Resources, Inc., BROG's parent. As a result, ConocoPhillips became the parent of Burlington Resources, Inc., which in turn, is the parent of BROG.

The function of the Trustee is to collect the net proceeds attributable to the Royalty (Royalty Income), to pay all expenses and charges of the Trust and distribute the remaining available income to the Unit Holders. The Trust does

not operate the Underlying Properties and, in fact, is not empowered to carry on any business activity. The Trust has no employees, officers or directors. All administrative functions of the Trust are performed by the Trustee.

BROG is the principal operator of the Underlying Properties. A very high percentage of the Royalty Income is attributable to the production and sale by BROG of natural gas from the Underlying Properties. Accordingly, the market price for natural gas produced and sold from the San Juan Basin heavily influences the amount of Royalty Income distributed by the Trust and, by extension, the price of the Units.

Table of Contents**Three Months Ended June 30, 2010 and 2009**

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 in Part II, Item 1. 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 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.

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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.

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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.

Six Months Ended June 30, 2010 and 2009

For the six months ended June 30, 2010, the Trust received Royalty income of \$44,452,655 and interest income of \$213,089. There was no change in cash reserves. After deducting administrative expenses of \$1,455,845, distributable income was \$43,209,899 (\$0.927076 per Unit) for the six months ended June 30, 2010. For the six months ended June 30, 2009, the Trust received Royalty income of \$12,024,685 and interest income of \$3,411. There was no change in cash reserves. After deducting administrative expenses of \$1,270,433, distributable income was \$10,757,663 (\$0.230807 per Unit) for the six months ended June 30, 2009.

The increase in distributable income from 2009 to 2010 resulted primarily from higher gas prices and lower capital expenditures during the first half of 2010 and the receipt of \$2,600,000 in settlement of the legal proceedings described in Part II, Item 1. Interest earnings for the six months ended June 30, 2010, as compared to the six months ended June 30, 2009 were higher primarily due the receipt of \$205,085 in interest due on the late payment of gross proceeds as a result of the ongoing negotiation of compliance audit issues and to an increase in funds available for investment. General and administrative expenses were higher for the six months ended June 30, 2010, as compared to the same period in 2009 primarily as a result of differences in timing in the receipt and payment of the expenses and also to increased costs associated with the litigation described below.

Capital expenditures incurred by BROG, attributable to the Underlying Properties, for the first six months of 2010 amounted to approximately \$5.7 million. Capital expenditures were approximately \$20.9 million for the first six months of 2009. Lease operating expenses and property taxes totaled \$15,642,446 and \$483,502, respectively, for the first six months of 2010, as compared to \$16,806,125 and \$490,021, respectively, for the first six months of 2009.

BROG has reported to the Trustee that during the six months ended June 30, 2010, 24 gross (5.43 net) conventional wells were completed on the Underlying Properties. There were 20 gross (11.32 net) coal seam wells and 46 gross (8.70 net) conventional wells completed on the Underlying Properties in the six months ending June 30, 2009.

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

	Six Months Ended June 30,	
	2010	2009
Gas:		
Total sales (Mcf)	16,239,746	17,069,622
Mcf per day	89,722	94,307
Average price (per Mcf)	\$ 5.14	\$ 3.43
Oil:		
Total Sales (Bbls)	27,861	26,275
Bbls per day	154	145
Average price (per Bbl)	\$ 69.71	\$ 38.22

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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:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2010	2009	2010	2009
<i>Gross proceeds of sales from the</i>				
<i>Underlying Properties:</i>				
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
<i>Less production costs:</i>				
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