SAN JUAN BASIN ROYALTY TRUST
Form 10-K
March 16, 2017
Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the Fiscal Year Ended December 31, 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. 001-08032

San Juan Basin Royalty Trust

(Exact name of registrant as specified in the Amended and Restated San Juan Basin Royalty Trust Indenture)

Texas	**75-6279898**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*
Compass Bank	
300 W. 7th Street, Suite B	
Fort Worth, Texas	**76102**
(Address of principal executive offices)	*(Zip Code)*

(866) 809-4553

(Registrant s telephone number, including area code)

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

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

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

None

(Title of Class)

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, 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

Aggregate market value of the Units of Beneficial Interest held by non-affiliates of the registrant as of June 30, 2016: $338,805,962.

At March 16, 2017 there were 46,608,796 Units of Beneficial Interest of the registrant outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

None.

Table of Contents

Table of Contents

Information Regarding Forward-Looking Statements

Certain information included in this Annual Report on Form 10-K contains, and other materials filed or to be filed by the San Juan Basin Royalty Trust (the Trust) with the Securities and Exchange Commission (the SEC) (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, as amended (the Exchange Act) and Section 27A of the Securities Act of 1933, as amended (the Securities Act). Such forward-looking statements may be or may concern, among other things, capital expenditures, drilling activity, development activities, production efforts and volumes, hydrocarbon prices, estimated future net revenues, estimates of reserves, the results of the Trust s activities, and regulatory matters. Such forward-looking statements generally are accompanied by words such as may, will, estimate, expect, predict, project, anticipate, goal, should, assume, believe, plan, intend, or other words that convey the uncertainty of future event Such statements are based on certain assumptions of Compass Bank, the Trustee (the Trustee) and by Burlington Resources Oil & Gas Company LP (Burlington), the owner of the working interest, 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 Burlington; and involve risks and uncertainties. However, whether actual results and developments will conform with such expectations and predictions is subject to a number of risks and uncertainties, including the risk factors discussed in Item 1A of Part I of this Annual Report, which could affect the future results of the energy industry in general, and the Trust and Burlington in particular, and could cause those results to differ materially from those expressed in such forward-looking statements. The actual results or developments anticipated may not be realized or, even if substantially realized, they may not have the expected consequences to or effects on Burlington s business and the Trust. Such statements are not guarantees of future performance and actual results or developments may differ materially from those projected in such forward-looking statements. The Trust undertakes no obligation to publicly update or revise any forward-looking statements, except as required by applicable law.

Burlington Information

As a holder of a net overriding royalty interest, the Trust relies on Burlington for information regarding Burlington itself; ConocoPhillips and its other affiliates; the Subject Interests (as defined below), including the operations, acreage, well count, production volumes, sales revenues, capital expenditures, operating expenses, reserves, drilling plans, drilling results and leasehold terms related to the Subject Interests; and factors and circumstances that have or may affect the foregoing. See Part II, Item 9A Controls and Procedures.

Table of Contents

GLOSSARY OF OIL AND NATURAL GAS TERMS

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

Bbl: Barrel, generally 42 U.S. gallons measured at 60 degrees Fahrenheit.

Bbls/d: Barrels per day.

Bcf: Billion cubic feet.

Btu: British thermal unit; the amount of heat necessary to raise the temperature of one pound of water one degree Fahrenheit.

Coal Seam Well: A well completed to a coal deposit found to contain and emit natural gas.

Conventional Well: A well completed to a formation historically found to contain deposits of oil or natural gas (for example, in the San Juan Basin, the Pictured Cliffs, Dakota and Mesaverde formations) and operated in the conventional manner.

Developed oil and natural gas reserves: Reserves of any category that can be expected to be recovered (i) through existing wells with existing equipment and operating methods or in which the cost of the required equipment is relatively minor compared to the cost of a new well; and (ii) through installed extraction equipment and infrastructure operational at the time of the reserves estimate if the extraction is by means not involving a well. See 17 CFR 210.4-10(a)(6).

Distributable Income: An amount paid to Unit Holders equal to the Royalty Income received by the Trustee during a given period plus interest, less the expenses and payment of liabilities of the Trust, adjusted by any changes in cash reserves.

Estimated future net revenues: Computed by applying current oil and natural gas prices (with consideration of price changes only to the extent provided by contractual arrangements and allowed by federal regulation) to estimated future production of proved oil and natural gas reserves as of the date of the latest balance sheet presented, less estimated future expenditures (based on current costs) to be incurred in developing and producing the proved reserves and assuming continuation of existing economic conditions. See 17 CFR 210.4-10(c)(4)(A). Estimated future net revenues are sometimes referred to in this Annual Report on Form 10-K as estimated future net cash flows.

GAAP: United States generally accepted accounting principles.

Grantor Trust: A trust (or portion thereof) with respect to which the grantor or an assignee of the grantor, rather than the trust, is treated as the owner of the trust properties and is taxed directly on the trust income for Federal income tax purposes under Sections 671 through 679 of the Internal Revenue Code of 1986, as amended.

Henry Hub: Henry Hub index.

Horizontal Well: A well that begins as a vertical or inclined linear bore, which extends from the surface to a subsurface location just above the target oil or natural gas reservoir, then bears off to intersect the reservoir and, thereafter, continues at a near-horizontal attitude to substantially or entirely remain within the reservoir until the desired bottom hole location is reached.

Table of Contents

Indenture: The Amended and Restated Royalty Trust Indenture, dated December 12, 2007 (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, and previously amended and restated effective September 30, 2002).

Infill Drilling: The drilling of wells intended to be completed to proven reservoirs or formations, sometimes occurring in conjunction with regulatory approval for increased density in the spacing of wells.

Lease Operating Expenses: Expenses incurred in the operation of a producing property as apportioned among the several parties in interest.

Mcf: Thousand cubic feet.

Mcf/d: Thousand cubic feet per day.

MMBtu: Million British thermal units.

MMcf: Million cubic feet.

Multiple Completion Well: A well which produces simultaneously, with or without separate tubing strings, from two or more producing horizons or alternatively from each.

Net Overriding Royalty Interest: A share of gross production from a property, measured by net profits from operation of the property and carved out of the working interest, i.e., a net profits interest.

Natural Gas Liquids (NGL): Those hydrocarbons that are separated from the gas as liquids through the process of absorption, condensation, adsorption or other methods in gas processing or cycling plants.

Present value of estimated future net revenues: Computed using the estimated future net revenues (as defined above) and a discount rate of 10%. See 17 CFR 210.4-10(c)(4)(A).

Proved developed reserves: Proved natural gas and oil reserves that can be expected to be recovered through existing wells with existing equipment and operating methods or in which the cost of the required equipment is relatively minor compared to the cost of a new well.

Proved natural gas and oil reserves: Those quantities of oil and natural gas, which, by analysis of geoscience and engineering data, can be estimated with reasonable certainty to be economically producible from a given date forward, from known reservoirs, and under existing economic conditions, operating methods, and government regulations prior to the time at which contracts providing the right to operate expire, unless evidence indicates that renewal is reasonably certain, regardless of whether deterministic or probabilistic methods are used for the estimation. The project to extract the hydrocarbons must have commenced or the operator must be reasonably certain that it will commence the project within a reasonable time. See 17 CFR 210.4-10(a)(22).

Proved undeveloped reserves (PUDs): Proved reserves that are expected to be recovered from new wells on undrilled acreage, or from existing wells where a relatively major expenditure is required for recompletion. Reserves on undrilled acreage shall be limited to those directly offsetting development spacing areas that are reasonably certain of production when drilled, unless evidence using reliable technology exists that establishes reasonable certainty of economic producibility at greater distances. Undrilled locations can be classified as having undeveloped reserves only if a development plan has been adopted indicating that they are schedule to be drilled within five years, unless specific circumstances justify a longer time. Under no circumstances shall estimates for proved undeveloped reserves be attributable to any acreage for which an application of fluid injection or other improved recovery technique is contemplated, unless such techniques have been proved effective by actual projects in the same reservoir or an analogous reservoir, or by other evidence using reliable technology establishing reasonable certainty.

Reasonable certainty: (i) If deterministic methods are used, reasonable certainty means a high degree of confidence that the quantities will be recovered or (ii) if probabilistic methods are used, there should be at least a 90% probability that the quantities actually recovered will equal or exceed the estimate. A high degree of confidence exists if the quantity is much more likely to be achieved than not, and, as changes due to increased availability of geoscience (geological, geophysical, and geochemical), engineering, and economic data are made to estimated ultimate recovery (EUR) with time, reasonably certain EUR is much more likely to increase or remain constant than to decrease. See 17 CFR 210.4-10(a)(24).

Reserves: Estimated remaining quantities of oil and natural gas and related substances anticipated to be economically producible, as of a given date, by application of development projects to known accumulations. In addition, there must exist, or there must be a reasonable expectation that there will exist, the legal right to produce or a revenue interest in the production, installed means of delivering oil and natural gas or related substances to market, and all permits and financing required to implement the project. See 17 CFR 210.4-10(a)(26).

Royalty: The principal asset of the Trust; the 75% net overriding royalty interest conveyed to the Trust on November 3, 1980, by Southland Royalty Company, the predecessor to Burlington, which was carved out of the Subject Interests.

Royalty Income: The net proceeds attributable to the Royalty.

Subject Interests: The working, royalty and other oil and natural gas interests owned by Southland Royalty Company, the predecessor to Burlington, in properties located in the San Juan Basin of northwestern New Mexico, out of which the Royalty was carved.

Undeveloped oil and natural gas reserves: Reserves of any category that are expected to be recovered from new wells on undrilled acreage, or from existing wells where a relatively major expenditure is required for recompletion. See 17 CFR 210.4-10(a)(31).

Units: The units of ownership of the Trust, comprised of undivided fractional interests in the beneficial interest of the Trust, equal to the number of shares of common stock of Southland Royalty Company outstanding at the close of business on November 3, 1980.

Working Interest: The operating interest under an oil and natural gas lease.

Table of Contents

PART I

ITEM 1. *BUSINESS*

The Trust is an express trust created under the laws of the State of Texas by the San Juan Basin Royalty Trust Indenture 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 (the Trustee), 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). Burlington is an indirect wholly-owned subsidiary of ConocoPhillips.

The Royalty functions generally as a net profits interest. Under the terms of the Conveyance, the Trust receives 75% of net proceeds from the Subject Interests. The term net proceeds, as used in the Conveyance, means the excess of gross proceeds received by Burlington during a particular period over production costs for such period. Gross proceeds means the amount received by Burlington (or any subsequent owner of the Subject Interests) from the sale of the production attributable to the Subject Interests, subject to certain adjustments. Production costs generally means costs incurred on an accrual basis by Burlington in operating the Subject Interests, including both capital and non-capital costs. For example, these costs include development drilling, production and processing costs, applicable taxes and operating charges. If production costs exceed gross proceeds in any month, the excess is recovered out of future gross proceeds prior to the making of further payment to the Trust, but the Trust is not otherwise liable for any production costs or other costs or liabilities attributable to the Subject Interests or the minerals produced therefrom. 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.

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.

As of December 31, 2016, 99% of the Trust s estimated proved reserves consisted of natural gas reserves, and 96% of the gross proceeds from the Subject Interests in 2016 were attributable to the production and sale by Burlington of natural gas. Accordingly, the market price for natural gas produced and sold from the San Juan Basin heavily influences the amount of Trust income available for distribution to the Unit Holders by the Trust and, by extension, the price of the Units. Normally there is greater demand for natural gas used for heating or air conditioning purposes in the summer and winter months than during the rest of the year.

The Trustee

The primary 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 to distribute the remaining available income to the

Table of Contents

Unit Holders. The Trust received approximately $16.8 million, $19.4 million and $61.5 million in Royalty Income from Burlington in each of the fiscal years ended December 31, 2016, 2015 and 2014, respectively. After deducting administrative expenses and accounting for interest income and any change in cash reserves, the Trust distributed approximately $13.9 million, $17.0 million, and $59.9 million to Unit Holders in each of the fiscal years ended December 31, 2016, 2015 and 2014, respectively. The Trust s corpus was approximately $7.8 million, $8.7 million, and $9.4 million as of December 31, 2016, 2015 and 2014, respectively.

Proceeds from production in the first month are generally received by Burlington in the second month, the net proceeds attributable to the Royalty are paid by Burlington to the Trustee in the third month, and distribution by the Trustee to the Unit Holders is made in the fourth month. Unit Holders of record as of the last business day of each month (the monthly record date) will be entitled to receive the calculated monthly distribution amount for such month on or before ten business days after the monthly record date. The amount of each monthly distribution will generally be determined and announced ten days before the monthly record date. The aggregate monthly distribution amount is the excess of (i) the net proceeds attributable to the Royalty paid to the Trustee, plus any decrease in cash reserves previously established for liabilities and contingencies of the Trust, over (ii) the expenses and payments of liabilities of the Trust, plus any net increase in cash reserves.

The Trustee may, in its sole discretion, establish a cash reserve for payment of Trust liabilities that are contingent or uncertain or otherwise not currently due and payable. As of December 31, 2016 and 2015, the Trustee had established cash reserves of $1.0 million and $0.5 million, respectively, for litigation expenses, which may increase as the parties prepare for trial. Cash reserves were increased by $0.5 million in 2016. The Trustee does not anticipate any further increases to the cash reserves in 2017.

Cash being held by the Trustee as cash reserves or pending distribution may be placed, in the Trustee s discretion, in obligations issued by (or unconditionally guaranteed by) the United States or any agency thereof, repurchase agreements secured by obligations issued by the United States or any agency thereof, certificates of deposit of banks having capital, surplus and undivided profits in excess of $50 million or money market funds that have been rated at least AAm by Standard & Poor s and at least Aa by Moody s, subject, in each case, to certain other qualifying conditions. Currently, such funds are placed in interest-bearing negotiable order of withdrawal accounts whose funds are either insured by the Federal Deposit Insurance Corporation or secured by other assets of Compass Bank.

The other powers and duties of the Trustee are set forth in the Indenture and include the prosecution and defense of claims by and against the Trust, the engagement of consultants and professionals and the payment of Trust liabilities. 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 if it determines such a sale is in the best interest of the Unit Holders. The Trust does not operate the Subject Interests and 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.

Under the Indenture, the Trustee may act in its discretion in carrying out its powers and performing its duties and is liable only for fraud or for acts and omissions in bad faith. The Trustee is not liable for any act or omission of its agents or employees unless the Trustee acted in bad faith in its selection and retention of such agents or employees. The Indenture provides that the Trustee and its officers, agents and employees must be indemnified and receive reimbursement of expenses from the assets of the Trust for liabilities and claims incurred in the administration of the Trust, except for liabilities and claims arising from the Trustee s fraud or bad faith.

Duration of the Trust

The Trust will terminate if (a) its gross revenue for each of two successive years is less than $1 million per year or, if earlier, (b) the Unit Holders of at least 75% of all of the Units outstanding vote in favor of termination. Upon termination of the Trust, the Trustee must sell the Royalty and distribute the proceeds to Unit Holders after satisfying or establishing reserves to satisfy the liabilities of the Trust.

Burlington

Burlington and other affiliates of ConocoPhillips are the principal operators of the majority of the Subject Interests. As an operator, Burlington has the obligation under the Conveyance to conduct its operations in accordance with reasonable and prudent business judgment and good oil and natural gas field practices. Burlington has the right to abandon any well when, in its opinion, such well ceases to produce or is not capable of producing oil and natural gas in paying quantities. Burlington reserves the right to not participate in operations on the Subject Interests when it has a right to do so under the applicable operating or similar agreement. 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. Additionally, Burlington is obligated under the Conveyance to maintain books and records sufficient to determine the amounts payable to the Trustee.

Additional Information

The principal office of the Trust is located at 300 West 7th Street, Suite B, Fort Worth, Texas 76102 (toll-free telephone number (866) 809-4553). The Trust makes available (free of charge) its annual, quarterly and current reports (and any amendments thereto) filed with the SEC through its website at *www.sjbrt.com* as soon as reasonably practicable after electronically filing or furnishing such material with or to the SEC. The Trust s materials filed with the SEC are also available at the SEC s Public Reference Room at 100 F Street, NE, Washington, DC 20549 or by calling the Public Reference Room of the SEC at 1-800-SEC-0330. The SEC also maintains the internet site of *www.sec.gov*. This site contains reports and, as applicable, proxy and information statements, and other information regarding the Trust and other issuers that file electronically with the SEC.

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, 300 West 7th Street, Suite B, Fort Worth, Texas 76102 (toll-free telephone number (866) 809-4553, email address: *sjt.us@bbva.com*), is the representative of the Trust that will provide tax information in accordance with the applicable U.S. Treasury Regulations governing the information reporting requirements of the Trust as a WHFIT and a NMWHFIT. The tax information is generally posted by the Trustee on the Trust s website: *www.sjbrt.com*.

ITEM 1A. ***RISK FACTORS***

Described below are certain risks that we believe are associated with an investment in the Units of the Trust and the oil and natural gas industry. There may be additional risks that are not presently material or known. You should carefully consider each of the following risks and all other information set forth in this Annual Report on Form 10-K. If any of the events described below occur, our financial condition could be materially adversely affected.

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

The Trust s monthly distributions are highly dependent upon the prices realized from the sale of natural gas and, to a lesser extent, oil. Oil and natural gas prices can fluctuate widely in response to a variety of factors that

Table of Contents

are beyond the control of the Trust and Burlington. Factors that contribute to price fluctuation include, among others:

- political conditions worldwide, in particular political disruption, war or other armed conflicts in oil producing regions;
- worldwide economic conditions;
- weather conditions;
- the supply and price of foreign oil and natural gas, including liquefied natural gas;
- the level of consumer demand;
- the price and availability of alternative fuels;
- the proximity to, and capacity of, transportation facilities;
- the effect of worldwide energy conservation and climate change measures; and
- technological advances in the methods for the exploration and production of natural gas.

Moreover, government regulations, such as regulation of natural gas transportation and price controls, can affect product prices in the long term. These factors and the volatility of the energy markets make it extremely difficult to predict future oil and natural gas price movements with any certainty. Oil and natural gas prices declined significantly during 2015 and 2016, and have remained low. During 2016, the price of natural gas and oil for production from the Subject Interests declined significantly from an average price for natural gas of $2.60 per Mcf in 2015 to $1.89 per Mcf in 2016, and the price for oil declined from an average price of $47.00 per Bbl in 2015 to $30.01 per Bbl in 2016. As a result of the price decline, certain wells have become less economical and, as a result, Burlington has reduced production from the Subject Interests. Natural gas production from the Subject Interests decreased from 29,128,439 Mcf in 2015 to 28,003,159 Mcf in 2016. See Item 7. Trustee s Discussion and Analysis of Financial Condition and Results of Operations.

Lower oil and natural gas prices will reduce proceeds to which the Trust is entitled and may ultimately reduce the amount of oil and natural gas that is economic to produce from the Subject Interests. As a result, Burlington or any third-party operator of any of the Subject Interests could determine during periods of low oil and natural gas prices to shut in or curtail production from wells on the Subject Interests. In addition, the operator of the Subject Interests could determine during periods of low oil and natural gas prices to plug and abandon marginal wells that otherwise may have been allowed to continue to produce for a longer period under conditions of higher prices. Specifically, Burlington or any third-party operator may abandon any well or property if it reasonably believes that the well or property can no longer produce oil and natural gas in commercially economic quantities. This could result in termination of the portion of the royalty interests relating to the abandoned well or property, and Burlington would have no obligation to drill a replacement well.

Burlington has informed us that it has not and does not intend to enter into derivative contracts or other hedging contracts with respect to the sale of production from the Subject Interests. Absent such arrangements, the revenue received from such production will be subject to market prices.

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

Production and development costs attributable to the Subject Interests are deducted in the calculation of net proceeds. Accordingly, higher production and development costs, without concurrent increases in revenues, decrease the share of net proceeds paid to the Trust as Royalty Income.

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

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

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

- historical production from the area compared with production rates from similar producing areas;
- the assumed effect of governmental regulation; and
- assumptions about future commodity price adjustments, production and development costs, severance and excise taxes, and capital expenditures.

Changes in these assumptions may materially change reserve estimates. Our estimate of proved natural gas reserves increased from 75,573 MMcf to 78,739 MMcf, as of December 31, 2015 and 2016, respectively, an increase of 3,166 MMcf, or approximately 4.2%. However, the discounted future net cash flows related to future Royalty Income from our proved reserves declined from $103.1 million to $93.5 million, as of December 31, 2015 and 2016, respectively, a decrease of approximately $9.6 million, or 9.3%. If low natural gas and oil prices persist or decrease further, the value of our estimated proved reserves and future Royalty Income may decrease substantially. For more information regarding our proved reserves, see Item 2. Properties Oil and Natural Gas Reserves and Item 8. Financial Statements and Supplementary Data, Note 9.

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

The future financial condition of operators of the Subject Interests could impede the operation of wells.

The value of the Royalty and the Trust s ultimate cash available for distribution is highly dependent on the financial condition of the operator of the wells. Neither Burlington nor any of the other operators of the Subject Interests has agreed with the Trust to maintain a certain net worth or to be restricted by other similar covenants.

The ability to operate the Subject Interests depends on all operators future financial condition and economic performance and access to capital, which in turn will depend upon the supply and demand for oil and natural gas, prevailing economic conditions and financial, business and other factors, many of which are beyond the control of such operators.

In the event of the bankruptcy of any operator of the Subject Interests, the working interest owners in the affected properties, creditors or the debtor-in-possession would have to seek a new party to perform the operations of the affected wells. Burlington or the other working interest owners may not be able to find a replacement operator, and they may not be able to enter into a new agreement with such replacement party on favorable terms or within a reasonable period of time. As a result, such a bankruptcy may result in reduced production of reserves and decreased distributions to Unit Holders.

Production of oil and natural gas on the Subject Interests could be materially and adversely affected by severe or unseasonable weather.

Production of oil and natural gas on the Subject Interests could be materially and adversely affected by severe or unseasonable weather. Repercussions of severe weather conditions may include:

- evacuation of personnel and curtailment of operations
- weather-related damage to drilling rigs or other facilities, resulting in suspension of operations
- inability to deliver materials to worksites; and
- weather-related damage to pipelines and other transportation facilities.

Due to the Trust s lack of industry and geographic diversification, adverse developments in the Trust s existing area of operation could adversely impact its financial condition, results of operations and cash flows and reduce its ability to make distributions to the Unit Holders.

The Subject Interests are operated for oil and natural gas production and are focused exclusively in the San Juan Basin. This concentration could disproportionately expose the Trust s interests to operational and regulatory risk in that area. Due to the lack of diversification in industry type and location of the Trust s interests, adverse developments in the oil and natural gas markets or the area of the Subject Interests, including, for example, transportation or treatment capacity constraints, curtailment of production or treatment plant closures for scheduled maintenance, could have a significantly greater impact on the Trust s financial condition, results of operations and cash flows than if the Royalty were more diversified.

The operators of the Subject Interests are subject to extensive governmental regulation that could affect the cost, manner and feasibility of conducting operations on the Subject Interests, which in turn could negatively impact Trust distributions, estimated and actual future net revenues to the Trust and estimates of reserves attributable to the Trust s interests.

Oil and natural gas operations on the Subject Interests are subject to laws and regulations adopted or promulgated by federal, state and local authorities. From time to time, those requirements may require Burlington and other operators of the Subject Interests to incur substantial costs or restrict production. Changes in price controls, taxes and environmental laws relating to the crude oil and natural gas industry have the ability to significantly affect crude oil and natural gas production, operations and economics. We cannot always predict with certainty whether agencies or courts will change their interpretation of existing requirements, whether government authorities will adopt new requirements or the effect such changes may have on our business or financial condition.

Environmental laws, in particular, may change frequently and at times may force Burlington and other operators of the Subject Interests to incur additional costs as those changes are implemented, or in instances of possible non-compliance, to incur penalties. Additionally, the discharge of natural gas, crude oil, or other pollutants into the air, soil or water may give rise to substantial liabilities to government agencies and third parties, and may require Burlington and other operators of the Subject Interests to incur substantial costs of remediation.

Some of the complex environmental requirements to which operation of the Subject Interests may be subject include the Comprehensive Environmental Response, Compensation and Liability Act, the Resource Conservation and Recovery Act, the Oil Pollution Act of 1990, the Clean Air Act, the Clean Water Act, the Endangered Species Act, the Safe Drinking Water Act, the Occupational Safety and Health Act and analogous state statutes along with regulations developed under these laws. See Item 2. Properties Regulation.

The future course of U.S. environmental regulation is especially difficult to predict at the current time because of uncertainties about the policies of the Trump Administration. For example, the federal government

Table of Contents

may or may not continue developing regulations to reduce greenhouse gas emissions from the oil and gas industry. Even if federal environmental efforts slow, states may continue pursuing new regulations.

Any new requirements under environmental or other statutes could increase the cost to operate the Subject Interests, change the nature of such operations, delay operations or reduce the liquidity of, or otherwise negatively impact, the financial condition of Burlington and the other operators of the Subject Interests. Such costs, delays and changes in operations could have a material adverse effect on the operation of the Subject Interests, which in turn could negatively impact Trust distributions, estimated and actual future net revenues to the Trust and estimates of reserves attributable to the Trust s interests.

Operating risks for Burlington and other operators of the Subject Interests can adversely affect Trust distributions.

Royalty Income payable to the Trust is derived from the sale of natural gas and oil production following the gathering and processing of those minerals, which operations are subject to risk inherent in such activities. Such risks include the following, which may result in production operations being curtailed, delayed or canceled:

- reductions in oil and natural gas prices;
- unusual or unexpected geological formations and miscalculations;
- equipment malfunctions, failures or accidents;
- lack of available gathering facilities or delays in construction of gathering facilities;
- lack of available capacity on interconnecting transmission pipelines;
- lack of available locations for disposal of brine and other wastes;
- unexpected operational events;
- pipe or cement failures and casing collapses;
- pressures, fires, blowouts and explosions;
- uncontrollable flows of oil, natural gas, brine, water or drilling fluids;
- natural disasters;
- environmental hazards, such as oil and natural gas leaks, pipeline ruptures and discharges of toxic gases or well fluids;

- adverse weather conditions, such as extreme cold, fires caused by extreme heat or lack of rain and severe storms or tornadoes; and

- market limitations for oil and natural gas.

If anticipated production is lower due to any of the factors above or for any other reason, or if Burlington incurs additional operational or production costs as a result of these or other factors, the amount of Trust distributions may be significantly reduced.

None of the Trustee, the Trust nor the Unit Holders control the operation or development of the Subject Interests.

Neither the Trustee nor the Unit Holders can influence or control the operation or future development of the Subject Interests. The Subject Interests are owned by Burlington, which operates a majority of such properties and handles the calculation of the net proceeds attributable to the Royalty and the payment of Royalty Income to the Trust. The Subject Interests that are not operated by Burlington are operated by other operators, some of which may be affiliated with Burlington. The development of the Subject Interests is conducted pursuant to

Table of Contents

operating and similar agreements to which the Trust is not a party and under which the Trust has no control or other rights to determine the location, timing and other key aspects of development and maintenance that may materially impact results of operations.

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

The Trustee may sell or dispose of any part of the assets of the trust with the affirmative vote the Unit Holders of 75% of all of the Units outstanding, except that 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. The Trust does not operate the Subject Interests and is not empowered to carry on any business activity. The Trust will be terminated and the Trustee must sell the Royalty if holders of at least 75% of the Units approve the sale or vote to terminate the Trust, or if the Trust s gross revenue for each of two successive years is less than $1million per year. Any net proceeds of a sale following termination of the Trust will be distributed to the Unit Holders after satisfying or establishing reserves to satisfy the liabilities of the Trust, and Unit Holders will receive no further distributions from the Trust. We cannot assure you that any sale of Trust assets will be on terms acceptable to all Unit Holders.

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

The Royalty Income payable to the Trust is derived from the sale of depleting assets. The reduction in proved reserve quantities is a common measure of depletion. Future maintenance and development projects on the Subject Interests will affect the quantity of proved reserves. The timing and size of these projects will depend primarily on the market prices of natural gas. If Burlington does not implement additional maintenance and development projects, the future rate of production decline of proved reserves may be higher than the rate currently expected by the Trust. Burlington has no contractual obligation to the Trust to make capital expenditures on the Subject Interests in the future. Furthermore, for properties on which Burlington is not designated as the operator, Burlington has no control over the timing or amount of capital expenditures. Burlington has a right to not participate in the capital expenditures on properties for which it is not the operator, in which case Burlington and the Trust will not receive the proceeds from the sale of the production resulting from such capital expenditures. The Trust is not permitted to acquire other oil and natural gas properties or royalty interests to replace the depleting assets and production attributable to the Trust.

Payment resulting from the Trust s audit exceptions to Burlington s calculation of Royalty Income may be significantly delayed, if payment is made at all.

Generally, each year the Trust completes an audit of Royalty Income for the previous fiscal year and provides notice to Burlington of audit exceptions during the second half of each year. Additional time is often required to resolve such audit exceptions, and in some cases, the audit exceptions have resulted in litigation lasting several years. Our audit of fiscal year 2016 Royalty Income may result in significant additional audit exceptions. Although we continue to seek resolution of these exceptions, we cannot provide any assurance as to whether they will be resolved in the Trust s favor and when they will be resolved. Audit exceptions may be resolved by court orders, settlement agreements between the parties and other methods that may not be favorable to the Trust and could result in a decrease in Royalty Income.

The amount of funds available for distribution to Unit Holders will be reduced by the amount of any cash reserves maintained by the Trustee in respect of anticipated future Trust expenses.

The Trustee is authorized to determine in its discretion the amount of cash reserves needed to pay liabilities and contingencies of the Trust. The amount of distributions to Unit Holders in a period is reduced by the amount of any increase in cash reserves for that period. The Trustee increased the cash reserves of the Trust from

$0.5 million as of December 31, 2015 to $1.0 million as of December 31, 2016. The Trustee does not anticipate any further increases to the cash reserves in 2017.

Unit Holders have limited voting rights.

Voting rights as a Unit Holder are more limited than those of stockholders of most public corporations. For example, there is no requirement for annual meetings of Unit Holders or for an annual or other periodic re-election of the Trustee. Unlike corporations, which are generally governed by boards of directors elected by their equity holders, the Trust is administered by a corporate trustee in accordance with the Indenture and other organizational documents. The Trustee has extremely limited discretion in its administration of the Trust. If the Trustee does not take appropriate action to enforce provisions of the Conveyance, the recourse of the Unit Holders would likely be limited to bringing a lawsuit against the Trustee to compel the Trustee to take specified actions. Unit Holders probably would not be able to sue Burlington or any other operator of the Subject Interests. The Indenture provides that the Trustee may only be removed and replaced by the holders of a majority of the outstanding Units, at a duly called meeting of Unit Holders. As a result, it may be difficult for public Unit Holders to remove or replace the Trustee without the cooperation of holders of a substantial percentage of the outstanding Units.

The limited liability of Unit Holders is uncertain.

The Unit Holders are not protected from the liabilities of the Trust to the same extent that a shareholder would be protected from a corporation s liabilities. The structure of the Trust does not include the interposition of a limited liability entity such as a corporation or limited partnership which would provide further limited liability protection to Unit Holders. While the Trustee is liable for any excess liabilities incurred if the Trustee fails to ensure that such liabilities are to be satisfied only out of Trust assets, under the laws of Texas, which are unsettled on this point, a Unit Holder may be jointly and severally liable for any liability of the Trust if the satisfaction of such liability was not contractually limited to the assets of the Trust and the assets of the Trust and the Trustee are not adequate to satisfy such liability. As a result, Unit Holders may be exposed to personal liability. The Trust, however, is not liable for production costs or other liabilities of the Subject Interests.

Conflicts of interest could arise between Burlington and the Trust.

Burlington could have interests that conflict with the interests of the Trust and the Unit Holders. For example, Burlington s interests may conflict with those of the Trust and the Unit Holders in situations involving the development, maintenance, operation or abandonment of the Subject Interests. Additionally, Burlington may abandon a well that is no longer producing in paying quantities even though such well is still generating revenue for the Unit Holders. Burlington may make decisions with respect to expenditures and decisions to allocate resources to projects in other areas that adversely affect the Subject Interests, including reducing expenditures on these properties, which could cause oil and natural gas production to decline at a faster rate and thereby result in lower cash distributions by the Trust in the future.

Burlington may sell its interest in the San Juan Basin.

Burlington may, without the consent or approval of the Unit Holders, sell all or any part of its retained interest in the Subject Interests. Burlington, a wholly-owned subsidiary of ConocoPhillips, and other affiliates of ConocoPhillips are the principal operators of the majority of the Subject Interests. In a November 10, 2016 News Release, ConocoPhillips announced the initiation of a $5 to $8 billion divestiture program, which will focus primarily on North American natural gas assets. News outlets have reported that the divestiture program will include the proposed sale of ConocoPhillips assets in the San Juan Basin. Although Burlington must require any purchaser(s) of its retained interest in the Subject Interests to assume Burlington s obligations with respect to those properties, such sale may not be in the best interests of the Trust and the Unit Holders. Any purchaser(s) may lack Burlington s experience in the Subject Interests or its creditworthiness. Furthermore, a sale by

Table of Contents

Burlington to one or more purchasers may increase the Trust s general and administrative expenses in the form of increased accounting, audit, legal, and administrative costs. ConocoPhillips has informed us that any sales process will be confidential. We cannot predict, and no assurances may be given, as to whether any or all of the Subject Interests will be sold, the timing of any such sale, the type of purchaser(s) or their plans (if any) to operate the Subject Interests.

Burlington may not be adequately insured against operational hazards.

Burlington is not obligated to the Trust to maintain any particular types or amounts of insurance, and insurance may not be commercially available at adequate levels to cover its operational hazards at all times during the life of the Trust. If a well is damaged, Burlington would have no obligation to drill a replacement well or otherwise compensate the Trust for the loss. The Trust does not have insurance or indemnification to protect against losses or delays in receiving proceeds from such events.

Financial information of the Trust is not prepared in accordance with GAAP.

The financial statements of the Trust are prepared on a modified cash basis of accounting, which is a comprehensive basis of accounting other than U.S. generally accepted accounting principles, GAAP. Although this basis of accounting is permitted for royalty Trusts by the Securities and Exchange Commission, the financial statements of the Trust differ from GAAP financial statements because revenues are not accrued in the month of production; certain cash reserves may be established for liabilities and contingencies of the Trust 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.

The Trust has not requested a ruling from the IRS regarding the tax treatment of the Trust. If the IRS were to determine (and be sustained in that determination) that the Trust is not a grantor trust for federal income tax purposes, the Trust could be subject to more complex and costly tax reporting requirements that could reduce the amount of cash available for distribution to Unit Holders.

If the Trust were not treated as a grantor trust for federal income tax purposes, the Trust may be properly classified as a partnership for such purposes. Although the Trust would not become subject to federal income taxation at the entity level as a result of treatment as a partnership, and items of income, gain, loss and deduction would flow through to the Unit Holders, the Trust s tax compliance requirements would be more complex and costly to implement and maintain, and its distributions to Unit Holders could be reduced as a result.

The Trustee has not requested a ruling from the U.S. Internal Revenue Service (IRS) regarding the tax status of the Trust, and the Trustee does not intend to request such a ruling or cannot assure you that such a ruling would be granted if requested or that the IRS will not challenge these positions on audit.

Unit Holders should be aware of the possible state tax implications of owning Units and should consult with their tax advisors.

Certain U.S. federal income tax preferences currently available with respect to oil and natural gas production may be eliminated as a result of future legislation.

Recently introduced legislation includes proposals that would, among other things, eliminate or reduce certain key U.S. federal income tax incentives currently available to oil and natural gas exploration and production companies. These changes include, but are not limited to the repeal of the percentage depletion allowance for oil and natural gas properties. It is unclear whether these or similar changes will be enacted and, if enacted, how soon any such changes could become effective. The passage of any legislation as a result of these proposals or any other similar changes in U.S. federal income tax laws could eliminate or postpone certain tax deductions that are currently available with respect to oil and natural gas exploration and development, could reduce the cash available for distribution to the Unit Holders or adversely affect the value of the Units.

Unit Holders are required to pay taxes on their share of the Trust s income even if they do not receive any cash distributions from the Trust.

Unit Holders are treated as if they own the Trust s assets and receive the Trust s income and are directly taxable thereon as if no Trust were in existence. Because the Trust generates taxable income that could be different in amount than the cash the Trust distributes, Unit Holders are required to pay any federal and applicable state income taxes and, in some cases, other state and local income taxes on their share of the Trust s taxable income even if they receive no cash distributions from the Trust. A Unit Holder may not receive cash distributions from the Trust equal to such Unit Holder s share of the Trust s taxable income or even equal