

Hugoton Royalty Trust

Hugoton Royalty Trust P.O. Box 962020, Fort Worth, Texas 76162-2020
855.588.7839 ● Southwest Bank, Trustee ● www.hgt-hugoton.com

1st

Quarter Report

2015

Condensed Statements of Distributable Income (Unaudited)

| | THREE MONTHS ENDED MARCH 31 | |
|---|-----------------------------|----------------------------|
| | 2015 | 2014 |
| Net Profits Income | \$ 4,136,842 | \$ 9,290,470 |
| Interest Income | 69 | 92 |
| Total Income..... | <u>4,136,911</u> | <u>9,290,562</u> |
| Administration Expense | <u>370,911</u> | <u>1,640,242</u> |
| DISTRIBUTABLE INCOME | <u>\$ 3,766,000</u> | <u>\$ 7,650,320</u> |
| DISTRIBUTABLE INCOME PER UNIT (40,000,000 UNITS) | <u>\$ 0.094150</u> | <u>\$ 0.191258</u> |

These condensed statements of distributable income should be read in conjunction with the financial statements and notes thereto included in the trust's 2014 annual report. For further information, see the trust's quarterly report on Form 10-Q for the quarter ended March 31, 2015.

Statements in this report to unitholders relating to future plans, predictions, events or conditions are forward-looking statements. All statements other than statements of historical fact included in this report to unitholders, including, without limitation, statements regarding the net profits interests, underlying properties, development activities, annual and monthly development, production and other costs and expenses, monthly development

cost deductions, oil and gas prices and differentials to NYMEX prices, supply levels, future drilling, workover and restimulation plans, the outcome of litigation and impact on trust proceeds, distributions to unitholders, industry and market conditions and the satisfaction or waiver of conditions to the trustee's resignation, are forward-looking statements that are subject to risks and uncertainties which are detailed in Part I, Item 1A of the trust's Annual Report on Form 10-K for the year ended December 31, 2014, which is incorporated by this reference as though fully set forth herein. XTO Energy and the trustee assume no duty to update these statements as of any future date.

Tax Information Per Unit

| | MONTHLY DISTRIBUTIONS PAID ON: | | | |
|------------------------------------|---|---------------------------|---------------------------|---------------------------|
| | (\$/UNIT EXCEPT COST DEPLETION FACTORS) | | | |
| | February 13, 2015 | March 13, 2015 | April 14, 2015 | Total |
| Gross Income..... | \$ 0.048677 | \$ 0.041391 | \$ 0.024025 | \$ 0.114093 |
| Less Severance Taxes | (0.004660) | (0.003620) | (0.002392) | (0.010672) |
| Interest Income | 0.000001 | 0.000001 | 0.000000 | 0.000002 |
| Less Administration Expenses..... | (0.005828) | (0.002949) | (0.002114) | (0.010891) |
| Reconciling Items..... | <u>0.001493</u> | <u>0.001264</u> | <u>(0.001139)</u> | <u>0.001618</u> |
| NET CASH DISTRIBUTION | <u>\$ 0.039683</u> | <u>\$ 0.036087</u> | <u>\$ 0.018380</u> | <u>\$ 0.094150</u> |
| Cost Depletion Factors: | | | | |
| Kansas - 80% | 0.000000 | 0.000000 | 0.000000 | 0.000000 |
| Oklahoma - 80%..... | 0.005825 | 0.004845 | 0.004213 | 0.014883 |
| Wyoming - 80% | 0.002463 | 0.006179 | 0.000000 | 0.008642 |



To Unitholders:

For the quarter ended March 31, 2015, net profits income was \$4,136,842, as compared to \$9,290,470 for first quarter

2014. The 55% decrease in net profits income is primarily the result of lower oil and gas prices (\$4.2 million), decreased oil and gas production (\$2.4 million) and the recoupment of natural gas liquids revenue in February 2015 (\$0.3 million), partially offset by lower development costs (\$0.9 million), decreased taxes, transportation and other costs (\$0.5 million) and excess costs on the Kansas and Wyoming underlying properties in 2015 (\$0.3 million). See "Net Profits Income" on the following page.

After adding interest income of \$69 and deducting administration expense of \$370,911, distributable income for the quarter ended March 31, 2015 was \$3,766,000, or \$0.094150 per unit of beneficial interest. Administration expense for the quarter decreased \$1,269,331 from the prior year quarter. Administration expense for the first quarter of 2015 included \$100,000 which the trustee reserved for administrative expenses and administration expense for first quarter 2014 included \$1,200,000 which the trustee reserved for legal expenses regarding the *Lamb* lawsuit which is now part of the reserve for the *Goebel* lawsuit. Changes in interest income are attributable to fluctuations in net profits income and interest rates. For first quarter 2014, distributable income was \$7,650,320 or \$0.191258 per unit.

Distributions to unitholders for the quarter ended March 31, 2015 were:

| RECORD DATE | PAYMENT DATE | PER UNIT |
|-------------------|-------------------|---------------------------|
| January 30, 2015 | February 13, 2015 | \$ 0.039683 |
| February 27, 2015 | March 13, 2015 | 0.036087 |
| March 31, 2015 | April 14, 2015 | <u>0.018380</u> |
| TOTAL | | <u>\$ 0.094150</u> |

Individualized tax information is provided annually to unitholders of record. Unitholders owning units in nominee name may obtain monthly tax information from the trustee upon request or from the trust's web site at www.hgt-hugoton.com.

This letter, and all communications to unitholders, includes information provided to the trustee by XTO Energy Inc.

Hugoton Royalty Trust
By: Southwest Bank, Trustee

By: Nancy G. Willis
Vice President

First Quarter Report 2015

Net Profits Income

Net profits income is recorded when received by the trust, which is the month following receipt by XTO Energy, and generally two months after oil and gas production. Net profits income is generally affected by three major factors:

- oil and gas sales volumes,
- oil and gas sales prices, and
- costs deducted in the calculation of net profits income.

The following are explanations of significant variances on the underlying properties from first quarter 2014 to first quarter 2015:

Sales Volumes

Gas sales volumes decreased 17% and oil sales volumes decreased 10% from first quarter 2014 to first quarter 2015. Decreased gas sales volumes are primarily due to repairs and maintenance in first quarter 2015 at a third party gas processing system in the Hugoton area following a force majeure incident and natural production decline. Decreased oil sales volumes are primarily due to the timing of cash receipts and natural production decline.

XTO Energy advised the trustee that repairs and maintenance in first quarter 2015 at a third party gas processing system in the Hugoton area following a force majeure incident resulted in decreased underlying gas volumes of approximately 5,000 Mcf per day. The third party has advised XTO Energy that it expects the repairs and maintenance to be completed by the middle of May 2015. However, XTO Energy has received notice that the force majeure notice is being extended to the processing portion of the third party plant due to an equipment malfunction. The third party will be able to bypass the plant and take gas, but, the plant is not expected to be able to process gas for NGLs or Helium until July 1, 2015. XTO Energy will continue to monitor the situation and assess its options.

The estimated rate of natural production decline on the underlying oil and gas properties is approximately 6% to 8% a year.

Sales Prices

Gas. The first quarter 2015 average gas price was \$3.48 per Mcf, a 20% decrease from the first quarter 2014 average gas price of \$4.35 per Mcf. Excluding the effects of the natural gas liquids recoupment in February 2015, the average gas price was \$3.59 per Mcf in the first quarter of

2015. For more information on the recoupment see “Other” on the following page. Natural gas prices are affected by the level of North American production, weather, crude oil and natural gas liquids prices, the U.S. economy, storage levels and import levels of liquefied natural gas. Natural gas prices are expected to remain volatile. The first quarter 2015 gas price is primarily related to production from November 2014 through January 2015, when the average NYMEX price was \$3.73 per MMBtu. The average NYMEX price for February and March 2015 was \$2.88 per MMBtu. At April 28, 2015, the average NYMEX futures price for the following twelve months was \$2.79 per MMBtu.

Oil. The first quarter 2015 average oil price was \$58.00 per Bbl, a 37% decrease from the first quarter 2014 average oil price of \$92.18 per Bbl. Oil prices are expected to remain volatile. The first quarter 2014 oil price is primarily related to production from November 2014 through January 2015, when the average NYMEX price was \$60.89 per Bbl. The average NYMEX price for February and March 2015 was \$48.41 per Bbl. At April 28, 2015, the average NYMEX futures price for the following twelve months was \$60.84 per Bbl.

Costs

Taxes, Transportation and Other. Taxes, transportation and other decreased 25% for the first quarter primarily because of decreased oil and gas production taxes and other deductions related to lower oil and gas revenues, partially offset by increased property taxes related to higher valuations.

Development Costs. Development costs deducted in the calculation of net profits income are based primarily on the current level of development expenditures and the development budget. Development costs for first quarter 2015 decreased 65% from the prior year quarter.

At December 31, 2014, cumulative budgeted costs deducted exceeded cumulative actual costs by approximately \$1.2 million. In calculating net profits income for the quarter ended March 31, 2015, XTO Energy deducted budgeted development costs of \$600,000. After considering actual development costs of \$1.4 million for the quarter, budgeted costs deducted exceeded cumulative actual costs by \$0.5 million. First quarter actual development costs primarily relate to disbursements for

First Quarter Report 2015

development activity in fourth quarter 2014.

XTO Energy has advised the trustee that total 2015 budgeted development costs for the underlying properties are between \$4 million and \$6 million. The 2015 budget year generally coincides with the trust distribution months from April 2015 through March 2016. The monthly development cost deduction will be reevaluated by XTO Energy and revised as necessary, based on the 2015 budget and the timing and amount of actual expenditures.

Excess Costs. XTO Energy advised the trustee that increased costs, decreased gas production and lower gas prices caused costs to exceed revenues by a total of \$22,501 (\$18,001 net to the trust) in January 2015 and decreased gas production and lower gas prices caused costs to exceed revenues by a total of \$316,167 (\$252,934 net to the trust) in February and March 2015 on properties underlying the Kansas net profits interest. However, these excess costs did not reduce net proceeds from the remaining conveyances.

XTO Energy advised the trustee that lower gas prices and increased costs caused costs to exceed revenues by a total of \$87,082 (\$69,666 net to the trust) in March 2015 on properties underlying the Wyoming net profits interest. However, these excess costs did not reduce net proceeds from the remaining conveyance.

Cumulative excess costs for the Kansas and Wyoming conveyances remaining as of March 31, 2015 totaled \$508,633 (\$406,906 net to the trust).

Other

XTO Energy advised the trustee that the February 2015 distribution included a one-time prior period adjustment for the recoupment of natural gas liquids revenue from the trust in the amount of \$353,069 (\$282,455 net to the trust) which was deducted from net proceeds for the first quarter of 2015.

Contingencies

In September 2008, a royalty class action lawsuit was filed against XTO Energy styled *Wallace B. Roderick Revocable Living Trust, et al. v. XTO Energy Inc.* in the District Court of Kearny County, Kansas. The case was removed to federal court in Wichita, Kansas. The plaintiffs allege that XTO Energy has improperly taken post produc-

tion costs from royalties paid to the plaintiffs from wells located in Kansas, Oklahoma, and Colorado; later reduced to Kansas. The case was certified as a class action in March 2012. XTO Energy filed an appeal of the class certification to the 10th Circuit Court of Appeals on April 11, 2012 which was granted on June 26, 2012. The court reversed the certification of the class and remanded the case back to the trial court for further proceedings. The case has been stayed pending a decision from the Kansas Supreme Court on the *Fawcett v. OPIK* appeal. In its pleadings, the plaintiff has alleged damages in excess of \$42.5 million.

In December 2010, a royalty class action lawsuit was filed against XTO Energy styled *Chieftain Royalty Company v. XTO Energy Inc.* in Coal County District Court, Oklahoma. XTO Energy removed the case to federal court in the Eastern District of Oklahoma. The plaintiffs allege that XTO Energy wrongfully deducted fees from royalty payments on Oklahoma wells, failed to make diligent efforts to secure the best terms available for the sale of gas and its constituents, and demand an accounting to determine whether they have been fully and fairly paid gas royalty interests. The case was certified as a class action in April 2012. XTO Energy filed an appeal of the class certification to the 10th Circuit Court of Appeals on April 26, 2012 which was granted on June 26, 2012. The court reversed the certification of the class and remanded the case back to the trial court for further proceedings.

XTO Energy has informed the trustee that it believes that XTO Energy has strong defenses to these lawsuits and intends to vigorously defend its position. However, XTO Energy has informed the Trustee that it is cognizant of other, similar litigation, such as *Fankhouser*, which is discussed in the trust's most recent Form 10-K, and other, unrelated cases against other, unrelated entities. As these cases develop, XTO Energy will assess its legal position accordingly. If XTO Energy ultimately makes any settlement payments or receives a judgment against it in *Chieftain or Roderick*, XTO Energy has advised the trustee that it believes that the terms of the conveyances covering the trust's net profits interests require the trust to bear its 80% share of such settlement or judgment related to production from the underlying properties. Additionally, if the judgment or settlement increases the amount of future

First Quarter Report 2015

payments to royalty owners, XTO Energy has informed the trustee that the trust would bear its proportionate share of the increased payments through reduced net proceeds. In the event of any such settlement or judgment, the trustee intends to review any claimed reductions in payment to the trust based on the facts and circumstances of such settlement or judgment. In light of the arbitration tribunal's decision on the treatment of the *Fankhouser* settlement, to the extent that the claims in *Chieftain* or *Roderick* are similar to those in *Fankhouser*, the trustee would likely object to such claimed reductions. XTO Energy has informed the trustee that, although the amount of any reduction in net proceeds is not presently determinable, in its management's opinion, the amount is not currently expected to be material to the trust's financial position or liquidity though it could be material to the trust's annual distributable income. Additionally, XTO Energy has advised the trustee that any reductions would result in costs exceeding revenues on the properties underlying the net profit interests of the cases named above, as applicable, for several monthly distributions, depending on the size of the judgment or settlement, if any, and the net proceeds being paid at that time, which would result in the net profits interest being limited until such time that the revenues exceed the costs for those net profit interests. If there is a settlement or judgment and should XTO Energy and the trustee disagree concerning the amount of the settlement or judgment to be charged, if any, against the trust's net profits interests, the matter will be resolved by binding arbitration through the American Arbitration Association under the terms of the Indenture creating the trust.

On September 12, 2012, a lawsuit was filed against Bank of America as trustee and XTO Energy styled *Harold Lamb v. Bank of America and XTO Energy Inc.*, in the U.S. District Court – Western District of Oklahoma. The plaintiff, Harold Lamb, is a unitholder in the trust and alleged that XTO Energy failed to properly pay and account to the trust under the terms of the net overriding royalty conveyances on certain Kansas and Oklahoma properties and that Bank of America, N.A., as the previous trustee, failed to properly oversee such payment and accounting by XTO Energy. Additionally, the plaintiff alleged that Bank of America, N.A. and XTO Energy breached a fiduciary duty to the trust based on the allegations found in the *Fankhouser* class

action discussed in the most recent Form 10-K. The plaintiff sought unspecified amounts for actual/compensatory damages, punitive damages, disgorgement and injunctive relief. On September 5, 2014, Lamb filed a Motion to Voluntarily Dismiss his claims. On September 29, 2014, the *Lamb* case was dismissed without prejudice to refile in state court. Lamb's counsel has been added as counsel of record for Goebel in *Sandra G. Goebel vs. XTO Energy, Inc., Timberland Gathering & Processing Company, Inc. and Bank of America, N.A.*

On August 12, 2013, a demand for arbitration styled *Sandra G. Goebel vs. XTO Energy, Inc., Timberland Gathering & Processing Company, Inc. and Bank of America, N.A.* was filed with the American Arbitration Association (“AAA”). The claimant, Sandra Goebel, is a unitholder in the trust and alleged that XTO Energy breached the conveyances by misappropriating funds from the trust by failing to modify its existing sales contracts with its affiliate Timberland Gathering & Processing Company, Inc. (“Timberland”). Goebel alleged that these contracts did not currently reflect “market rate” terms, and that XTO had a duty to renegotiate the contracts to obtain more favorable terms. The claimant further alleged that Bank of America, N.A. (the previous trustee) breached its fiduciary duty by acquiescing to and facilitating XTO Energy's alleged self-dealing and concealing information from unitholders that would have revealed XTO Energy's breaches. The claim also alleged aiding and abetting breach of fiduciary duty by XTO Energy, and disgorgement and unjust enrichment by Timberland. The claimant sought from the respondents damages of an estimated \$59.6 million for alleged royalty underpayments, exemplary damages, an accounting by XTO Energy, a declaration, costs, reasonable attorneys' fees, and pre-judgment and post-judgment interest. Goebel purported to sue on behalf of and for the benefit of the Hugoton Royalty Trust. Bank of America, N.A. filed a response to the arbitration demand denying any liability arising out of the claimant's allegations and objecting to the arbitrability of Goebel's claims against Bank of America, N.A. The arbitration panel ruled that Goebel's claims are not arbitrable and dismissed the claims in their entirety without prejudice. Goebel has refiled the matter as a lawsuit styled *Sandra G. Goebel vs. XTO Energy, Inc., Timberland Gathering and Processing*

First Quarter Report 2015

Company, Inc. and Bank of America, N.A. in Dallas County District Court. The allegations are the same as those contained in the previous arbitration demand. Defendants answered with general denials and additionally filed pleas to the jurisdiction, special exceptions, and a plea in abatement challenging, among other things, Goebel's putative authority to bring claims on behalf of the trust over the trustee's objection. The Defendants also filed a joint motion to stay the *Goebel* case in favor of the first filed *Lamb* case discussed above. The court denied Defendants' pleas to the jurisdiction and special exceptions, although it did not rule on the plea in abatement. Simultaneously, the judge conditionally stayed the case pending a ruling on Goebel's Motion to Intervene in the *Lamb* case. On September 5, 2014, however, Goebel withdrew her Motion to Intervene. That same day, Lamb filed a Motion to Voluntarily Dismiss his federal district court lawsuit (see discussion above). Goebel filed a motion to lift the stay in the state district court; while XTO Energy, Timberland and Bank of America (individually and now as former trustee) filed a motion to stay the case pending a mandamus appeal of the district court's denial of their pleas to the jurisdiction and special exceptions. On October 30, 2014, the district court granted Plaintiff's motion to lift stay. On October 31, 2014, the district court denied Defendants' motion to stay pending mandamus. On November 7, 2014, the Defendants filed their petition for writ of mandamus with the Dallas Court of Appeals. Defendants also filed a motion seeking a stay from the court of appeals, along with the petition for writ of mandamus. On November 13, 2014, the court of appeals granted Defendants' motion and stayed the lawsuit, including all associated discovery, until the court opines on the petition for writ of mandamus. Goebel filed a response to the petition for the writ of mandamus on December 16, 2014 and the Defendants replied on January 13, 2015. Accordingly, the petition has been fully briefed and is

awaiting a decision from the court of appeals. Southwest Bank, the current trustee, has not yet been named a party in the case. The trustee will vigorously defend any claims that may be asserted against it. XTO Energy has informed the trustee that it believes that XTO Energy and Timberland have strong defenses to this lawsuit and intend to vigorously defend their positions. Bank of America has informed the trustee that it believes it has strong defenses to the lawsuit and will vigorously defend its position. The terms of the trust indenture provide that Bank of America and/or the trustee shall be indemnified by the trust and shall have no liability, other than for fraud, gross negligence or acts or omissions in bad faith as adjudicated by final non-appealable judgment of a court of competent jurisdiction.

The trustee anticipates that the trust will incur additional legal and other expenses in connection with the *Goebel* lawsuit. As a result, the trustee reserved an additional \$1.6 million from trust distributions for the *Goebel* litigation, beginning with the September 2013 distribution. The September 2013 through December 2013 distributions each reflected a deduction of \$400,000 in connection with such reserve. Additionally, the trustee previously reserved an additional \$1.6 million from trust distributions for the *Lamb* litigation but that is now a part of the reserve for the *Goebel* lawsuit. The January 2014 through April 2014 distributions each reflected a deduction of \$400,000 in connection with such reserve. As the *Goebel* lawsuit progresses, the trustee may need to revise the reserve.

Certain of the underlying properties are involved in various other lawsuits and governmental proceedings arising in the ordinary course of business. XTO Energy has advised the trustee that it does not believe that the ultimate resolution of these claims will have a material effect on the financial position or liquidity of the trust, but may have an effect on annual distributable income.

For information contact:

Hugoton Royalty Trust

Southwest Bank, Trustee

P.O. Box 962020

Fort Worth, Texas 76162-2020

(855) 588-7839

www.hgt-hugoton.com

Glossary of Terms

| | |
|--------------|--|
| Bbl | Barrel (of oil) |
| Mcf | Thousand cubic feet (of natural gas) |
| MMBtu | One million British Thermal Units, a common energy measurement |

Calculations of Net Profits Income

The following is a summary of the calculation of the net profits income received by the trust:

| | THREE MONTHS ENDED MARCH 31 ^(a) 2015 | 2014 | INCREASE (DECREASE) |
|---------------------------------------|--|---------------------|------------------------|
| SALES VOLUMES | | | |
| Gas (Mcf) ^(b) | | | |
| Underlying Properties..... | 3,714,450 | 4,449,201 | (17%) |
| Average Per Day..... | 40,374 | 48,361 | (17%) |
| Net Profits Interests..... | 953,182 | 1,734,374 | (45%) |
| Oil (Bbl) ^(b) | | | |
| Underlying Properties..... | 49,386 | 54,745 | (10%) |
| Average Per Day..... | 537 | 595 | (10%) |
| Net Profits Interests..... | 16,562 | 26,096 | (37%) |
| AVERAGE SALES PRICES | | | |
| Gas (per Mcf) | \$ 3.48 | \$ 4.35 | (20%) |
| Oil (per Bbl) | \$ 58.00 | \$ 92.18 | (37%) |
| REVENUES | | | |
| Gas sales..... | \$12,908,609 | \$19,339,408 | (33%) |
| Oil sales..... | 2,864,366 | 5,046,572 | (43%) |
| TOTAL REVENUES | 15,772,975 | 24,385,980 | (35%) |
| COSTS | | | |
| Taxes, transportation and other | 1,950,142 | 2,603,689 | (25%) |
| Production expense..... | 5,415,493 | 5,414,648 | — |
| Development costs..... | 600,000 | 1,700,000 | (65%) |
| Overhead..... | 3,062,037 | 3,054,555 | — |
| Excess Costs | (425,750) | — | — |
| TOTAL COSTS..... | 10,601,922 | 12,772,892 | (17%) |
| NET PROCEEDS | 5,171,053 | 11,613,088 | (55%) |
| NET PROFITS PERCENTAGE | 80% | 80% | |
| NET PROFITS INCOME | \$ 4,136,842 | \$ 9,290,470 | (55%) |

(a) Because of the two-month interval between time of production and receipt of net profits income by the trust, oil and gas sales for the quarter ended March 31 generally represent production for the period November through January.

(b) Oil and gas sales volumes are allocated to the net profits interests based upon a formula that considers oil and gas prices and the total amount of

production expense and development costs. As product prices change, the trust's share of the production volumes is impacted as the quantity of production to cover expenses in reaching the net profits break-even level changes inversely with price. As such, the underlying property production volume changes may not correlate with the trust's net profit share of those volumes in any given period. Therefore, comparative discussion of oil and gas sales volumes is based on the underlying properties.