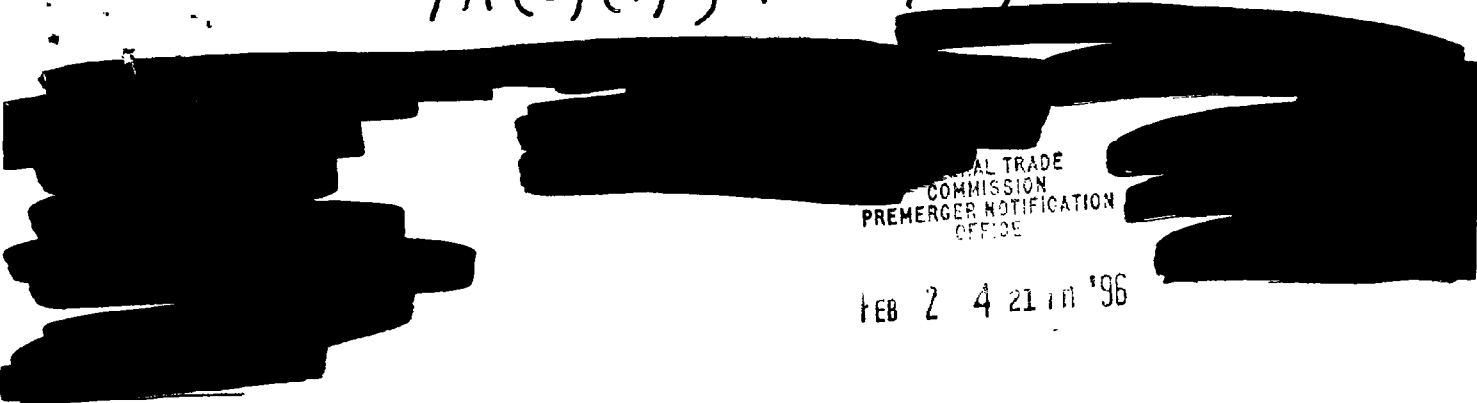


7A(c)(1); 7A(c)(2)



FEDERAL TRADE
COMMISSION
PREMERGER NOTIFICATION
OFFICE

FEB 2 4 21 10 '96

February 2, 1996

CONFIDENTIAL

By Hand

Richard B. Smith, Esq.
Premerger Notification Office
Federal Trade Commission
Room 310
6th Street and Pennsylvania Ave., N.W.
Washington, D.C. 20004



Dear Dick:

Following up on our telephone conversation of Wednesday, this letter is intended to elaborate on my letter to you of January 30, 1996. Specifically, this letter sets forth additional information about the "production payment" that was described in my earlier letter.

For purposes of federal income taxes, Section 636 of the Internal Revenue Code treats a production payment as a mortgage interest. In other words, for income tax purposes, the grantor of the production payment is considered to have borrowed money from the grantee and the loan is deemed secured by a mortgage on the oil and gas properties in question.

Under [redacted] law, a production payment is a royalty interest, in this case in gas production. Although the holder of a production payment may have implied or contractual rights to cause the party that has the legal rights under the mineral lease to exploit and produce the mineral, the production payment interest alone does not entitle the royalty owner itself to conduct those exploration and production operations. Therefore, it is not a classic interest in real property, such as, for example, a co-tenancy, which would authorize each person to possess and occupy a piece of real estate.

CONFIDENTIALITY OF INFORMATION
OF THE FEDERAL TRADE COMMISSION
IS NOT GUARANTEED BY THE
COMMISSION



Richard B. Smith
February 2, 1996
Page 2

CONFIDENTIAL

As you and I discussed, law provides that a production payment is considered to be a real property interest (i.e. a royalty); however, once the gas is produced from the well, then the severed gas constitutes personal property. There is case law in other states, however, that suggests that a production payment interest is other than a real property interest, perhaps, for example, a debt or an equitable lien.

The length of the production payment in the transaction at hand is measured by a volume of production; it is expected in this case to take approximately three years or a bit more in order to produce the share attributable to the production payment. When that volume of gas has been delivered, the production payment will terminate.

We greatly appreciate the attention you gave to our request for advice earlier this week. We are well aware of the great demands on the Premerger Office and your immediate response greatly assisted the parties to the transaction.

If you have any further questions, please call.

Sincerely,

2/6/96 Advised writer that the integrated oil and gas company's taking of the production payment from the natural gas producer was clearly a TA (C) (1) transaction. Its sale of an undivided percentage interest in the production payment to Oil and Gas Financing Company, which will take the gas and sell it to the producer, raises more difficult issues. However, since Financing Company is engaged in the business of financing "production payments" in its ordinary course of business, any collateral interest which it might acquire in the producer's property (or in gas produced therefrom) appears to be part of its financing activities for such transactions and, as such, should qualify for a TA (C) (1) exemption. Might also be viewed as the purchase of an interest in a mortgage, which would be exempt under TA (C) (2).

RBSmith