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July 09, 2021

In Re:

LEGEND

Company	=
Sub 1	=
Sub 2	=
Marketer	=
Producer	=
Sub A	=
Sub B	=
Sub C	=
Sub D	=
D-Sub 1	=
Supplier	=
Business	=
Gas Exchange	=
Commission Order	=
System	=
State A	=
State B	=
State C	=
State D	=
State E	=
State F	=
Year 1	=
Date 1	=
Date 2	=
a	=
b	=
Director	=

Dear :

This letter responds to your request, dated December 1, 2020, for a letter ruling regarding the federal income tax consequences under sections 613A(c) and 291(b) of the Internal Revenue Code (Code) with respect to certain natural gas transactions. The relevant facts as represented in your request, and in supplemental submissions dated April 2, 2021 and May 20, 2021, are set forth below.

FACTS

Company is a company headquartered in State A. It is the corporate parent of a consolidated federal income tax group that includes Marketer, Producer, and Supplier. Company is a calendar year taxpayer for federal income tax purposes, is on the accrual method of accounting, and files a consolidated federal income tax return.

Company wholly owns Sub 1, a corporation for federal income tax purposes. Sub 1 wholly owns Sub 2, an entity disregarded as separate from Sub 1 for federal income tax purposes. Sub 2's business includes natural gas pipelines. Sub 2 wholly owns Marketer, an entity disregarded as separate from Sub 1 for federal income tax purposes. Marketer wholly owns Producer, a corporation for federal income tax purposes.

Sub 2 also wholly owns Sub A, which wholly owns Sub B, which wholly owns Sub C, which wholly owns Sub D. Each of Sub A, Sub B, and Sub C is disregarded as an entity separate from Sub 1 for federal income tax purposes. Sub D is a corporation for federal income tax purposes. Sub D wholly owns two subsidiaries, D-Sub 1 and Supplier. D-Sub 1 and Supplier are disregarded as entities separate from Sub D for federal income tax purposes.

Company represents that as an entity disregarded as separate from Sub D, all assets owned (and all business activities conducted) by Supplier should be treated for federal income tax purposes as owned (and conducted) directly by Sub D, and that as such, while "Supplier" is referred to in order to reflect the actual legal and commercial relationships between the applicable parties, for federal income tax purposes any reference to Supplier is a reference to its regarded owner, Sub D.

Producer is a holding company that owns (directly and indirectly) numerous entities engaged in the oil and gas production business. Producer owns Sub 2's gas-producing entities, including those involved in natural gas, natural gas liquids, and oil production. Producer's portfolio includes interests in approximately a producing wells through wholly-owned subsidiaries, and non-operated or joint venture interests. Producer and its subsidiaries produce natural gas and sell the vast majority of their production to Marketer. Marketer then markets the natural gas to unrelated third

parties. Marketer also acquires natural gas in the open market from unrelated parties and sells that natural gas to Supplier.

Company also has another business, Business, a company in State A. Certain subsidiaries or affiliates of Business are engaged in certain natural gas-related operations, but neither Business nor any of its subsidiary entities purchase or sell Producer's gas, directly or indirectly.

Sub C acquired Sub D on Date 1. Sub D and its subsidiaries are retail providers serving customers in State B, State C, State D, State E, and State F. Sub D is headquartered in State F. Sub D's subsidiary Supplier is a natural gas supplier to retail customers in states including State B, State C, State D, and State E. Supplier delivers natural gas to a local distribution company (typically at the city gate). The local distribution company will then deliver the natural gas to the retail customer. Neither Company, nor Sub D, nor Supplier sells oil or oil-related products at retail.

Supplier's gross revenues from retail natural gas sales are expected to exceed $5 million for the first time in Year 1. Company represents that as of the date of its ruling request, Sub D is neither a "retailer" under § 1.613A-7(r) nor a "refiner" under § 1.613A-7(s), nor has Sub D ever been a retailer or refiner under these respective provisions. Company also represents that neither Company nor any of its directly or indirectly owned entities is a "refiner" within the meaning of § 613A(d)(4).

Marketer serves as the transacting party for the execution of risk management and asset optimization strategies with respect to Sub 2's assets. Marketer manages the fuel needs of Sub 2's assets, as well as the output from Sub 2 assets that do not have long-term contracts in place. Marketer also provides a wide range of natural gas commodity products, and energy marketing and trading services. In this capacity, Marketer acquires natural gas, either from Producer assets, unrelated parties that own natural gas wells, or the open market, and supplies natural gas to unrelated wholesale customers. Marketer also supplies natural gas to Supplier to serve its retail needs.

Natural gas is priced and traded at market hubs located at interconnect points across the United States. Interconnect points are intersections of major pipeline systems. There are over 30 major market hubs in the United States, the principal of which is the Henry Hub in Louisiana. The futures contracts traded on the New York Mercantile Exchange are Henry Hub contracts that reflect the price of natural gas for physical delivery at this hub. The price at which natural gas trades differs across the major hubs, depending on the supply and demand for natural gas at that particular point. The difference between the Henry Hub price and that of another hub is generally referred to as the location differential.

The natural gas pipeline transmission system is premised on gas flowing from higher to lower pressure. At a basic level, from the well, natural gas goes into gathering lines, which get larger and larger as they get closer to a central collection point. From

the gathering system, natural gas moves into the transmission system, which is generally composed of approximately 300,000 miles of steel pipes. The transmission system moves large amounts of natural gas thousands of miles from the producing regions to local distribution companies.

After natural gas is acquired (and after any requisite processing, treatment, and/or local transportation), the next step is generally to schedule transportation so that the natural gas can reach its ultimate customer or location of consumption. In order to facilitate transportation, the owner of the gas must be a shipper on a transmission pipeline (or broader pipeline system). The shipper places a nomination (i.e., a request for gas transportation) with the pipeline that includes the receipt point, quantity of gas, and the drop off or delivery location. Nominations can be made in a variety of cycles (with various timing deadlines). After a nomination is submitted, the pipeline owner/operator must communicate and confirm with the shipper that supply will be forthcoming and communicate with the counterparty (i.e., the customer or the acquirer of the gas) that the gas will be delivered. After all the confirmations have been made, the pipeline owner/operator will schedule the transportation.

The scheduled amount is based on nominations submitted by service requesters (i.e., a supplier or shipper). Service requesters may nominate conflicting gas quantities (i.e., where a service requester may deliver more gas than another service requester has nominated to receive from them). These discrepancies are rectified during the scheduling process. The scheduling function is comprised of three primary steps: balancing, allocation, and confirmation. Accordingly, the amount of gas scheduled may differ from the nomination amount due to any of these three steps. No gas is actually transported during the nomination process. Rather, the final allocation and confirmation occurs during the scheduling process. Nominations and scheduling happen on a continuous, albeit defined, basis.

As electronic demand forecasts are imperfect, demand could be higher or lower than expected. The difference between the amount of gas scheduled and the amount of gas delivered or consumed is an “imbalance.” Imbalances can be resolved in numerous ways, including, but not limited to, the following: (i) shippers can borrow or leave gas in the pipeline by over- or under-nominating gas on another day to offset the imbalance; (ii) shippers can trade imbalances with other shippers; or (iii) intraday cycles (of nominations and scheduling) can be used to adjust gas flow, thus eliminating imbalances. In certain situations, imbalances can also be cured or rectified through the trading of economic entitlements at various hubs (as opposed to trading specified hydrocarbons).

In order to operate an effective market for the purchase and sale of natural gas, parties maintain gas pools, which are a tally of economic entitlements to a certain amount of natural gas at a specific interconnect point (as opposed to a specific claim on specified hydrocarbons). Economic pools exist at each of the city gate locations. City gate stations consist of metering and pressure-regulating facilities and are located at the

custody transfer points where natural gas is delivered from the transmission pipelines into the high-pressure lines of the local distribution company. The use of gas pools is common in the industry and is generally required by market participants in the transfer and procurement of natural gas at the applicable market points. Gas pools serve as nomination tools that allow parties to economically aggregate natural gas supply from several sources at a specific interconnect point or specified location. Once a source of supply is aggregated into an applicable economic pool, such supply can be nominated with the pipeline owner/operator (to further request receipt and delivery points of natural gas).

At each interconnect point or designated market location where either Producer's gas could be sold or transferred, or Supplier's natural gas demand could be satisfied, Marketer maintains a specified gas pool which is identified by (or otherwise related or in reference to) Marketer's System number. At each such location, all of Marketer's natural gas supply (whether acquired by Marketer from Producer, or from an unrelated market participant) is aggregated into the applicable pool, which, as opposed to representing specific hydrocarbons, represents an economic entitlement to a quantum of hydrocarbons.

Marketer procures all of Supplier's natural gas needs (approximately b MMBtu/day during months of peak demand). Supplier does not purchase gas from any other parties and does not purchase gas electronically (e.g., via the Gas Exchange). In a typical transaction, Marketer procures natural gas for Supplier (and Supplier directs Marketer to provide natural gas) at a location where Supplier has sufficient capacity on a pipeline to transport the gas to its customers. As a competitive retailer, Supplier maintains a portfolio of gas transport which determines the location where Supplier must procure natural gas in order to transport the gas to its customers. Marketer does not manage this capacity for Supplier.

Marketer also purchases natural gas from Producer, arranges transportation of the gas, sells the gas to other unrelated wholesale market participants, and provides other producer services such as: (i) nominations, scheduling, and balancing; and (ii) asset management, including transportation, storage, acquisition, utilization, optimization, and arbitrage. In a typical transaction, Marketer will take title to the Producer's natural gas and, after the gas is processed and/or treated, transport the gas on a gathering line to a larger intrastate or interstate pipeline. Once in the pipeline, Marketer may sell the gas to an unrelated third party or transport the gas to another marketable location. If the gas is transported further downstream from the point of title transfer, the transport occurs either using capacity leased by Producer (and released to Marketer) or using capacity that Marketer holds due to other business in its portfolio.

Producer's natural gas, upon sale to Marketer (and after requisite processing, treatment, and/or local transportation), enters the natural gas pipeline transmission system and is immediately transported downstream of the interconnect point. Producer's natural gas is not held at a captive, specified location owned and controlled

by Marketer. Company represents that once natural gas enters the transmission system, Marketer has an economic claim on a specified quantum of hydrocarbons at a particular location, as opposed to a physical claim on specific hydrocarbons at a specified location. Company represents that after Producer sells its hydrocarbons to Marketer (and after further treatment, processes, and/or required transportation, but in each event prior to subsequent sale), the hydrocarbons enter the natural gas transmission system, and, once in the system: (i) are not separated or sequestered into physical pools, or at a specified physical location; (ii) are transported in accordance with the applicable flow of the system; and (iii) may be acquired by any number of market participants in the transmission system. Marketer has no specific knowledge of where any specific hydrocarbon is transported or stored. Company represents that if Marketer transfers natural gas into the natural gas pipeline transmission system at a specific interconnect point, and immediately thereafter decides to extract natural gas from the same interconnect point, it is a factual impossibility that the hydrocarbons extracted would be those that were previously deposited by Marketer into such point.

Marketer sells natural gas purchased from Producer pursuant to one of three methods: (i) via a direct bilateral sale to a third party; (ii) via the broker market; or (iii) electronically via the Gas Exchange.

Bilateral sales occur when Marketer negotiates and transacts directly with the purchaser. Marketer negotiates directly with the bilateral counterparty and is aware of the identity of the counterparty from the inception of negotiations.

In a broker deal, Marketer negotiates with the broker as an intermediary between the two potential counterparties to the deal. Marketer does not know the identity of the counterparty until Marketer agrees to the terms arranged by the broker. Once each counterparty agrees to the terms of the deal, the broker identifies each counterparty to the other counterparty, and the counterparties arrange the logistics of scheduling and delivering the natural gas themselves.

The Gas Exchange is the exchange of choice to transact natural gas in the United States. Transactions on the Gas Exchange are similar to those of the broker market because Marketer does not know the identity of the counterparty until after Marketer has agreed to the terms of the deal. Parties wishing to buy or sell natural gas on the Gas Exchange post bids on the Gas Exchange. A bid price is the highest price a potential purchaser is willing to pay. Once a bid is accepted, the counterparties are bound by the terms of the agreed deal, and the Gas Exchange reveals each party's identity. The parties then arrange the logistics of scheduling and delivering the natural gas.

Marketer and Supplier have entered into a base contract for the sale and purchase of gas acquired from an unrelated third-party (Base Contract), as well as Special Provisions that are attached to and form a part of the Base Contract (Special Provisions). Under the terms of the Base Contract and Special Provisions (collectively,

Supply Agreement), Supplier will acquire from Marketer natural gas which is acquired from an unrelated third party and purchased by Marketer in the open market. Specifically, the term “Gas,” as used in the Supply Agreement, is defined to only reference gas acquired from an unrelated third party (and not to include any gas produced by an affiliate of Marketer, including, for example, gas produced by Producer). Further, all Gas delivered by Marketer to Supplier is contractually required to have been procured in the open market from an unrelated third-party.

The Supply Agreement provides that Marketer agrees to sell and deliver the “Contract Quantity” of Gas with Gas acquired from an unrelated third party on hand at the time of Supplier’s request for Gas, and, in the event Marketer does not have available such amount of Gas, Marketer will procure from an unrelated third party in the open market any such additional Gas as required to meet the Contract Quantity amounts. The Supply Agreement further provides that Supplier agrees to receive and purchase the Contract Quantity for a particular transaction in accordance with the terms of the Contract for the “Contract Price.”

Under the Supply Agreement, the terms Contract Quantity and Contract Price are defined to reference (or to be determined by reference to) unrelated third-party gas. The Supply Agreement also provides that Marketer and Supplier will coordinate their nomination activities to facilitate the procurement by Marketer of unrelated third-party market gas sufficient to satisfy Marketer’s obligations under the agreement.

Company represents that Supplier does not participate in the broker market and does not transact on the Gas Exchange and therefore, that Supplier cannot inadvertently directly acquire natural gas produced by Producer using either the Gas Exchange or the broker market. Additionally, Company represents that internal controls prohibit direct transactions between Producer and Supplier. Producer has not and will not contract directly with Supplier, and no direct sales from Producer to Supplier will take place.

At each specified location (including any location where both (i) natural gas produced by Producer could be sold or transferred, and (ii) Supplier requires natural gas supply), Marketer aggregates its supply into an applicable natural gas pool and transacts with market participants out of such pool. For any applicable location where natural gas is traded on the Gas Exchange (i.e., locations where an active, liquid market exists for natural gas), there are no direct transactions between Producer and Supplier. Instead, Marketer, through the use of its applicable pool, may buy or sell natural gas on the Gas Exchange (which could include sales of natural gas that Marketer purchased from Producer, as well as purchases of natural gas on the Gas Exchange meant to satisfy a supply request from Supplier). Additionally, there may be instances where Marketer sells natural gas produced by Producer and purchases natural gas for Supplier at the same location that is not traded on the Gas Exchange, but the Supply Agreement prohibits sales of Producer-produced gas to Supplier.

Additionally, under Commission Order, natural gas pipelines must offer pipeline shippers a minimum of four nomination opportunities to schedule natural gas transportation – two nomination opportunities prior to the day of gas flow (the timely nomination cycle and the evening nomination cycle), and two nomination opportunities on the day of gas flow (intra-day cycles 1 and 2). At the end of each trading day (after trading hours), Marketer creates a report that highlights (i) any economic pool from which Supplier is scheduled to take gas, and (ii) the volume of third-party gas at that pool on the day that Supplier will take the gas. Company represents that as of the date of its ruling request, the internal controls with respect to such a report would be finalized and implemented prior to Date 2. Company represents that Marketer's report will identify any shortcomings (i.e., days in which third-party gas in a particular economic pool does not equal or exceed the amount of gas taken by Supplier at that pool on that day) the morning that the gas is scheduled to flow. Company represents that Marketer will thus be able to nominate and flow third-party gas in the pool on the day the gas flows to match or exceed the gas that flows to Supplier, in accordance with Marketer's obligations under the Supply Agreement.

Company makes the following representations:

1. Producer does not own a significant ownership interest in Supplier.

2. Producer's production is sold by Marketer to persons unrelated to Producer and unrelated to Supplier (and Supplier is contractually prohibited from acquiring natural gas produced by Producer).

3. Other than acquiring gas from Marketer, Supplier does not purchase oil or natural gas from Producer's customers or persons related to Producer's customers.

4. There are no arrangements whereby Supplier acquires for resale oil or natural gas that Producer produced or made available for purchase by Supplier.

5. Neither Producer nor Supplier knows or controls the final disposition of the oil or natural gas sold by Producer or the original source of the petroleum products acquired for resale by Supplier.

6. The gathering lines, pipelines, and interconnections used by Supplier to procure and resell natural gas are connected solely to gas lines owned by unrelated third parties. Accordingly, Supplier has no specific knowledge that Producer's oil or natural gas is or will be commingled with other producers' oil or natural gas that is or may be acquired for resale by Supplier.

RULING REQUESTED

Company requests a ruling that notwithstanding the retail operations of Sub D, which are conducted by Supplier (an entity disregarded as separate from Sub D for

federal income tax purposes), or the marketing operations of Marketer, Producer will qualify as an independent producer for purposes of § 613A(c) and will not be an integrated oil company for purposes of § 291(b).

LAW AND ANALYSIS

Section 291(b)(1)(A) provides that an integrated oil company is required to reduce the deduction for certain intangible drilling and developmental costs allowable under § 263(c) by 30 percent.

Section 291(b)(2) provides that the amount disallowed as a deduction under § 291(b)(1)(A) shall be allowable as a deduction ratably over the 60-month period beginning with the month in which the costs are paid or incurred.

Section 291(b)(4) provides that for purposes of § 291(b), the term “integrated oil company” means, with respect to any taxable year, any producer of crude oil to which § 613A(c), relating to independent producers and royalty owners, does not apply by reason of § 613A(d)(2) or (d)(4), relating to certain retailers or refiners, respectively.

Section 611 generally provides for a depletion deduction in the case of mines, oil and gas wells, other natural deposits, and timber.

Section 1.611-1(a) provides that in the case of exhaustible natural resources other than timber, the allowance for depletion is computed upon either the adjusted depletion basis of the property (see § 612, relating to cost depletion), or upon a percentage of gross income from the property (see § 613, relating to percentage depletion), whichever results in the greater allowance for depletion for any taxable year.

Section 613A(a) provides that except as otherwise provided in § 613A, the allowance for depletion under § 611 with respect to any oil and gas well is computed without regard to § 613.

Under § 613A(c), independent producers and royalty owners are allowed a deduction for percentage depletion with respect to limited quantities (depletable quantities) of domestic crude oil or natural gas production. Section 613A(c) does not apply to any taxpayer that is a retailer or refiner, as defined in § 613A(d)(2) and (d)(4), respectively.

Section 613A(d)(2) provides that a retailer is any taxpayer that (subject to a $5 million de minimis sale rule) directly, or through a related person, sells oil or natural gas (excluding bulk sales of such items to commercial or industrial users), or any product derived from oil or natural gas (excluding bulk sales of aviation fuels to the Department of Defense) – (A) through any retail outlet operated by the taxpayer or a related person, or (B) to any person – (i) obligated under an agreement or contract with the taxpayer or a related person to use a trademark, trade name, or service mark or name owned by

such taxpayer or a related person, in marketing or distributing oil or natural gas or any product derived from oil or natural gas, or (ii) given authority, pursuant to an agreement or contract with the taxpayer or a related person, to occupy any retail outlet owned, leased, or in any way controlled by the taxpayer or a related person.

Section 613A(d)(3) provides that for purposes of § 613A(d), a person is a related person with respect to the taxpayer if a significant ownership interest in either the taxpayer or such person is held by the other, or if a third person has a significant ownership interest in both the taxpayer and such person. Section 613A(d)(3) further provides that the term "significant ownership interest" means, with respect to any corporation, 5 percent or more in value of the outstanding stock of such corporation.

Section 613A(c)(8)(A) provides that for purposes of § 613A(c) (relating to independent producers and royalty owners) persons that are members of the same controlled group of corporations are treated as one taxpayer. Section 613A(c)(8)(A) does not apply to the provisions within § 613A(d).

Section 1.613A-7(r)(2) provides that for purposes of § 1.613A-7(r)(1) (defining "retailer"), a taxpayer shall be deemed to be selling oil or natural gas (or a product derived therefrom) through a related person in any case in which any sale of oil or natural gas (or a derivative product) by the related person produces gross income from which the taxpayer may benefit by reason of its direct or indirect ownership interest in the related person. Section 1.613A-7(r)(2) further provides that in such cases (and in any other case in which the taxpayer is selling through a retail outlet referred to in § 613A(d)(2)(A) or is selling such items to a person described in § 613A(d)(2)(B), it is immaterial whether the oil or natural gas which is sold, or from which is derived a product which is sold, was produced by the taxpayer.

Section 1.613A-7(r)(2) also provides that a taxpayer shall be deemed to be selling oil or natural gas (or a derivative product) through a retail outlet operated by a related person in any case in which a related person that operates a retail outlet acquires for resale oil or natural gas (or a derivative product) which the taxpayer produced or caused to be made available for acquisition by the related person pursuant to an arrangement whereby some or all of the taxpayer's production is marketed.

Section 1.613A-7(r)(3) provides that for purposes of § 1.613A-7(r), the term "any product derived from oil or natural gas" means products that are recovered from petroleum refineries or extracted from natural gas in field facilities or natural gas processing plants. Section 1.613A-7(r)(3) further provides that the term retail outlet means any place where sales of oil or natural gas (excluding bulk sales of such items to commercial or industrial users), or a product of oil or natural gas (excluding bulk sales of aviation fuels to the Department of Defense), accounting for more than 5 percent of the gross receipts from all sales made at such place during the taxpayer's taxable year, are systematically made for any purpose other than for resale.

In Rev. Rul. 85-12, 1985-1 C.B. 181, a wholly-owned subsidiary of a holding corporation produced oil and gas that it sold at or near the wellhead to unrelated parties. Another wholly-owned subsidiary of the same holding corporation was a retailer of petroleum or petroleum products it purchased from unrelated parties, selling more than $5 million annually to end users. The holding corporation filed a consolidated return with its subsidiaries. The revenue ruling concludes that the producer subsidiary had no direct or indirect ownership interest in the retailer subsidiary, and, thus, did not benefit from the retail sales. Although the two subsidiaries were related persons for purposes of § 613A(d), none of the producer subsidiary's production was, in form or substance, sold through the retailing subsidiary. Thus, the producer subsidiary was not precluded from taking the percentage depletion deduction as provided in § 613A(c) or from being treated as an independent producer for purposes of the former windfall profit tax.

Rev. Rul. 92-72, 1992-2 C.B. 118, describes a situation under which a taxpayer is not considered to be selling oil or natural gas through a related retailer and therefore is not considered a retailer itself for purposes of § 613A(d)(2). In the revenue ruling: (1) the taxpayer does not own a significant ownership interest in the retailer; (2) the taxpayer sells its production to persons unrelated to the taxpayer and unrelated to the retailer; (3) the retailer does not purchase oil or natural gas from the taxpayer's customers or persons related to the taxpayer's customers; (4) there are no arrangements whereby the retailer acquires for resale oil or natural gas that the taxpayer produced or made available for purchase by the retailer; and (5) neither the taxpayer nor the retailer knows or controls the final disposition of the oil or natural gas sold by the taxpayer or the original source of the petroleum products acquired for resale by the retailer.

Based on the information submitted and the representations made, we conclude that notwithstanding the retail operations of Sub D, which are conducted by Supplier (an entity disregarded as separate from Sub D for federal income tax purposes), or the marketing operations of Marketer, Producer will qualify as an independent producer for purposes of § 613A(c) and will not be an integrated oil company for purposes of § 291(b).

Except as specifically determined above, no opinion is expressed or implied concerning the federal income or other tax consequences of the matters described above. This ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent. This ruling is based upon information and representations submitted by the taxpayer and accompanied by a penalties of perjury statement executed by the appropriate party. While this office has not verified any of the material submitted in support of the request for a ruling, it is subject to verification on examination.

In accordance with the power of attorney on file with this office, a copy of this letter ruling is being sent to your authorized representative. A copy of this letter ruling is also being sent to Director.

Sincerely,

/s/ Patrick S. Kirwan
Chief, Branch 6
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

cc: