SELECT ENERGY SERVICES

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July 31, 2015

Via Federal eRulemaking Portal

Internal Revenue Service
CC:PA:LPD:PR (REG-132634-14)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

Re: Comments on Code Section 7704 Proposed Regulations (REG–132634–14)

Dear Sir or Madam:

Select Energy Services, LLC ("***Select***") is America's largest independent water solutions company servicing the oil and gas industry. We have approximately 3,500 employees devoted to providing every aspect of water solutions services. We source water for hydraulic fracturing, we deliver the water to the drilling area, we assemble storage tanks and provide high speed water transfer services at the wellsite, we provide onsite flowback and production testing services, and we collect and dispose of waste fluids that are recovered at the wellsite. Yet, while the proposed regulations (REG–132634–14) (the ***"Proposed Regulations"***) recognize the critical importance of water handling in the production of oil and gas, it appears that a significant portion of our income will not be qualifying under the standards included in the Proposed Regulations.

This anomalous result was likely unintended and, in any event, is based upon an incomplete understanding of the water solutions business and can easily be remedied through minor changes to the Proposed Regulations. As discussed in detail below, the proposed regulations have two major flaws:

1. They fail to recognize that the provision of water to the wellsite often includes the provision of substantial specialized services at the wellsite. For example, we have more than 1200 personnel exclusively dedicated to providing water services at the wellsite. The combination of specialized wellsite services coupled with the provision of an injectant that is critical to the drilling process should be sufficient to satisfy the "intrinsic" standard. To remedy this issue, we propose that a partnership providing an injectant be able to satisfy the "specialization" standard if in connection with providing the injectant the partnership also handles, treats, or monitors the use of the injectant in connection with its use at the site of its use. This will allow the specialization standard to be satisfied by partnerships that do much more than simply deliver a fungible good to the wellsite, but may not be engaged in disposal services at a particular wellsite.

2. The Proposed Regulations fail to recognize that market participants, even though they offer both water supply and disposal services, frequently only provide one of the two services on any particular well. As discussed below, this is a result of competitive forces in the market. The Proposed Regulations unfairly tilt the competitive playing field in favor of market participants whose affiliates are oil and gas producers that can assure that their captive fluid handling company provides both elements of the fluid service at the wellsite. To remedy this issue, we propose that the disposal requirement may be satisfied if the partnership is materially engaged in disposal operations in the same geographic area.

Specifically, we propose the following two changes to §1.7704-4(d)(ii):

(ii) To the extent that the activity includes the sale, provision or use of property, either:

...

(B) The property is used as an injectant to perform a section 7704(d)(1)(E) activity that is also commonly used outside of section 7704(d)(1)(E) activities (such as water, lubricants, and sand) and, **either (1)** as part of the activity, the partnership also, **handles, treats, or monitors the use of the injectant in connection with its use at the site of its use, or** collects**,** ~~and~~ cleans, recycles, or otherwise disposes of the injectant after use in accordance with federal, state, or local regulations concerning waste products from mining or production activities **or (2) within the same geographic region as the activity, the partnership also engages in the collection, cleaning, recycling or disposal of the same type of injectant after use in accordance with federal, state, or local regulations concerning waste products from mining or production activities. For purposes of this paragraph (B), a partnership will not be considered to engage in the collection, cleaning, recycling or disposal of an injectant within the same geographic region as it provides the injectant unless it, in the ordinary course of business, seeks to provide such collection, cleaning, recycling or disposal services to the same category of customers to which it provides injectant within a geographic region and the partnership actually provides such collection cleaning, recycling or disposal services within the geographic region other than in a *de minimis* manner.**

Change 1

Change 2

While both changes are warranted, they are not dependent on each other. Each of the changes should be reviewed separately.

The proposed changes are carefully tailored to be entirely consistent with the IRS and Treasury's view expressed in the preamble to the Proposed Regulations that "intrinsic activities constitute active support of section 7704(d)(1)(E) activities, and not merely the supply of goods."

Select – A Water Solutions Leader

Select is engaged in the business of providing a full suite of frac fluid related services to customers in the oil and gas production sector, operating through three business units: Water

Solutions, Well Testing and Fluids Handling. Through these three business units, Select offers customers a broad set of highly-specialized services essential to the production of oil and gas, including the sourcing of water; the transportation of water to the wellsite through overland pipe and hose along with trucking; fluid containment, monitoring and measuring services at the wellsite; the filtering and treatment of drilling fluids, well testing, pumping and separation services associated with flowback water, collection of flowback water and produced formation water at the wellsite; and the transportation and cleaning, recycling or disposal of drilling, completion and production fluids. Select operates in each of the major shale basins in North America, and with $675 million in revenues in 2014 and approximately 3,500 employees, we believe we are the largest independent water solutions company servicing the oil and gas industry.

The Unintended Impact of the Proposed Regulations

The Proposed Regulations provide that certain limited support activities intrinsic to section 7704(d)(1)(E) activities (which we also refer to as "***qualifying activities***") will also give rise to qualifying income because the income is derived from a qualifying activity. The Proposed Regulations also provide that an activity will be considered intrinsic only if it (i) is specialized to support the qualifying activity (the "***specialization requirement***"), (ii) is essential to the completion of the qualifying activity and (iii) requires the provision of significant services to support the qualifying activity.

Under the Proposed Regulations, activities that involve the provision of an injectant that has common usage outside of a section 7704(d)(1)(E) activity—such as water—will only satisfy the specialization requirement if "as part of the activity, the partnership also collects and cleans, recycles, or otherwise disposes of the injectant after use in accordance with federal, state, or local regulations concerning waste products from mining or production activities." The injectant portion of the specialization requirement appears to be the result of careful consideration by the Internal Revenue Service (the "***IRS***") and Department of Treasury ("***Treasury***") as to how to view an activity that involves the provision of a fungible good, and we understand the IRS and Treasury's desire to limit the situations in which the provision of a fungible good would generate qualifying income. In this regard, differentiating between companies that simply provide water to oil and gas companies to utilize in hydraulic fracturing, and those that provide both water **and** specialized services with respect to the frac fluids is logically sound. In practice, however, we believe the Proposed Regulations do not differentiate between those partnerships providing only fresh water, on the one hand, and those providing fresh water and specialized services with respect to that water, on the other hand. Instead, when the specialization requirement is actually applied to full-service frac fluid handling companies like us, their water sourcing and transportation services will generally **not** be qualifying.

This result is driven by two factors: (i) regardless of the degree of services that are provided at the wellsite, the Proposed Regulations require that a partnership providing fresh water sourcing and transportation services must also provide fluid-related services downstream from the same well after the water is initially provided in order for the water sourcing and transportation to be a qualifying activity; and (ii) despite third-party service providers best efforts, they are rarely able to successfully contract with customers to provide fluid handling services upstream and downstream of the same wellsite, due to competitive factors and customer preferences.

Accordingly, even though Select provides substantial services at the wellsites to which it delivers water and offers "cradle to grave" water solutions and fluid handling services, and markets these services broadly to its customers, almost all of its water sourcing and transportation activities will not be qualifying under the Proposed Regulations.

In practice, the Proposed Regulations will distinguish between independent frac fluid service providers, who rarely contract with customers to provide fluid services on both sides of the same well and thus will not be able to ensure their water sourcing activities are qualifying, and service companies that are affiliated with or owned by their oil and gas customers, and thus able to provide fluid services throughout the life cycle of individual wells without competitive concerns. Our suggested modifications to the Proposed Regulations would remedy this inconsistency while still carefully limiting the scope of situations in which the provision of a fungible good may constitute a qualifying activity.

Overview of the Frac Fluid Services Industry

Water is essential to the development and completion of oil and gas wells in many of the major shale producing regions in the United States, where oil and gas producers rely on hydraulic fracturing or "fracking" to stimulate production of natural gas and/or oil from dense subsurface rock formations. The hydraulic fracturing process involves the injection of sand, water and chemicals under pressure through a cased and cemented wellbore into targeted subsurface formations to fracture the surrounding rock and allows hydrocarbons to flow into the wellbore for extraction. The amount of water utilized is significant. For example, during the early development phase of the unconventional shales from 2008 through 2010, each well used approximately 3 million gallons of water per well. Currently, with the continued improvement and use of advanced horizontal technology, wells use approximately 9 million gallons of water per well during the fracturing process, though this may vary significantly depending on a variety of factors, particularly the shale area within which the well is drilled.

Managing this water throughout the drilling, completion and production cycle of the well is a critical service to oil and natural gas companies. Water sources are often difficult to locate and secure access to, particularly in the quantities required for multi-well development programs. Once located, the water must be delivered to the wellsite under stringent performance standards for utilization in the fracking process. After the water is pumped into the well, it returns to the surface over time. Ten to fifty percent of the water returns as flowback water during the first several weeks following the fracking process, and a large percentage of the remainder, as well as pre-existing water in the formation, returns to the surface as produced water over the life of the well. Both the flowback and produced water must be recovered through the use of specialized equipment and personnel, and either treated and recycled or transported off-site for disposal. Due to the massive amounts of water and fluid involved in the hydraulic fracturing process, production of oil and gas using the hydraulic fracturing process would not be commercially viable without fluid handling services.

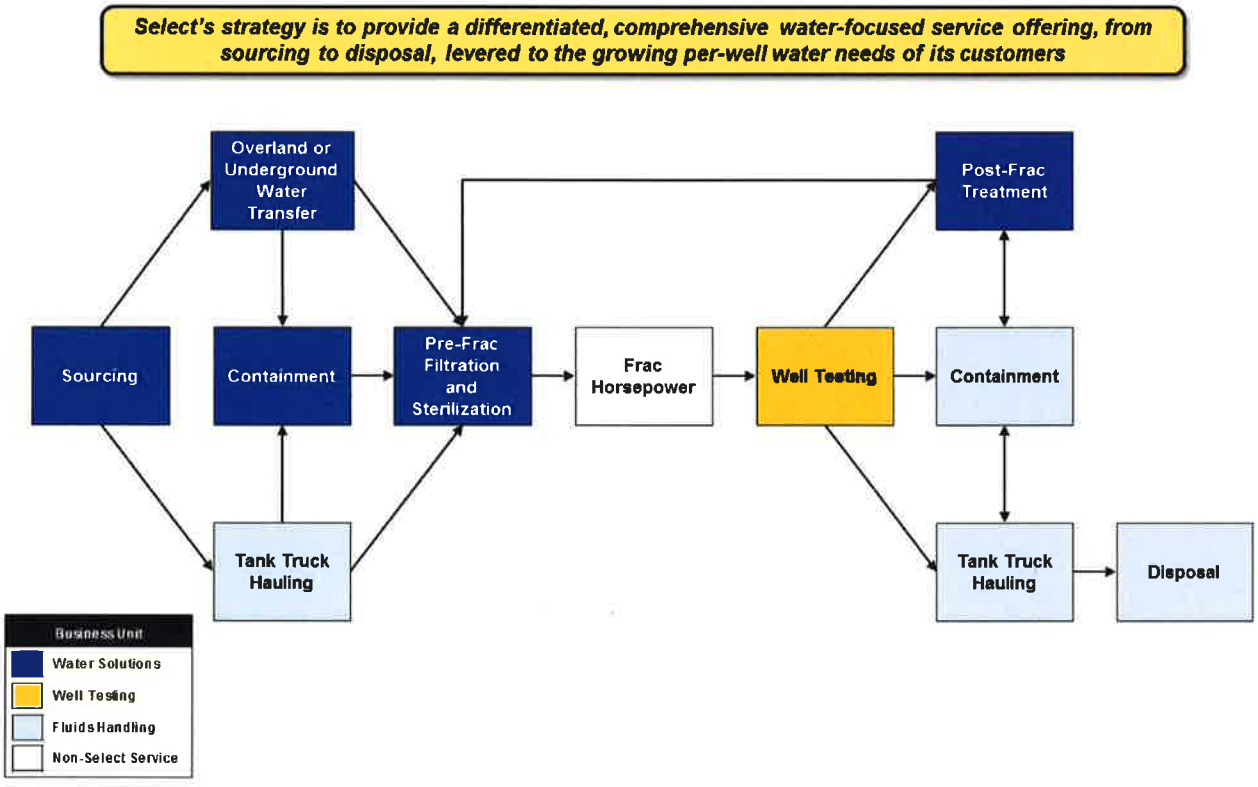
Delivering the variety of water-related services required by an oil or natural gas producer is a specialized and complex process, with regulatory, geological and technical issues that vary between basins and geographic areas. For example, the availability of fresh water sources and the

regulatory regimes governing the sourcing of fresh water vary not only between, but within states, as local water resources may be regulated by state agencies, regional water basin commissions and local water planning agencies. In addition, the volume of flowback water returned to the surface varies significantly between basins, and the presence and composition of naturally occurring compounds that dissolve into the flowback during the fracturing process varies from one shale region to the next. Due to these and other complexities involved in the production of oil and gas, as well as the increased regulation and governmental scrutiny of the use, treatment and disposal of water in fracking, many oil and natural gas producers have shown a desire to outsource the services associated with water solutions to third party providers, which possess the requisite equipment, experienced and specialized personnel, water rights and governmental relationships necessary to provide reliable fluid services.

Overview of Fluid Services

The following flowchart depicts the fluid services necessary in connection with completing a well after drilling. As the chart indicates, these services occur in all three phases of the exploration and production for oil and gas: upstream of the frac wellsite, at the frac wellsite and downstream of the frac wellsite.

Water Used During Life-Cycle of the Well



A brief summary of the services provided upstream of the wellsite, at the wellsite and downstream of the wellsite is as follows.

Fluid Services Upstream of the Wellsite.

Upstream of the wellsite, fluid services companies provide services including water sourcing and water transfer services, which may be through pipelines, above-ground hose or tank trucks. Water sourcing typically involves locating, securing contractual rights to and permitting the utilization of fresh water for hydraulic fracturing activities, and may involve negotiations with individual land owners, municipal, federal, local and state governments, and private industry. Given the significant regulatory framework applicable to water sourcing, many service providers employ highly trained professionals with expertise in a variety of fields; for example, Select's water sourcing experts have degrees in Environmental Science, Geology, Geography, and Natural Resource Management—with more than half holding Master's Degrees in related fields, and their work experience includes prior service with state water regulatory agencies, conservation districts, oil and gas operations and water-focused environmental firms. Frequently, these contractual rights or permits are issued exclusively for use associated with oil and gas activities, without alternative use.

Fluid service companies will contract with oil and gas producers to provide fresh water for use in completion activities, and transport the water to large containment areas near wellsites that the fluid service provider may also design, engineer and construct for the customer's use when completion activities begin. Typically, the preferred method of transfer, both for its reliability and cost, is utilizing above ground water transfer pipeline/hose systems. By utilizing these systems of temporary pipelines/hose, water storage facilities and pumps, service providers offer high-volume, high-rate water transfer services. These systems are carefully tailored by specially trained engineers and other qualified personnel, with experience addressing the topographical and subsurface challenges presented in various geographic areas. In addition, technical personnel will work closely with professionals who specialize in negotiating and securing rights-of-way and easements necessary to construct and operate the water transfer systems. In areas where water transfer through overland pipe is geographically prohibitive, fluid service providers will also provide water transfer services utilizing tank trucks. Additionally, in some areas of very dense drilling activity on very remote geography, underground pipeline systems may be designed, constructed and installed for drilling and completions activities. These pipeline and hose transportation systems, whether temporary or permanent, are typically designed exclusively to transport water from source directly to oil and gas operations, often times in very geographically remote locations, with little alternative utility.

The pipeline systems and tank trucks that transport water from the source to the drilling area typically terminate at large freshwater impoundments that are strategically positioned in the general vicinity of a customer's wells. These impoundments are necessary to ensure there is adequate volume of water on hand to accommodate the demand for fluid services for multiple simultaneous fracking projects. A critically important component of Select's services is being able to provide and have available the amount of water to accommodate all the fracking contemplated and being able to timely deliver the water to the frac operator as needed. Therefore, specialized monitoring and measuring services and equipment are required at containment or important locations. A typical impoundment is an in-ground, lined containment facility having an earthen containment berm around the perimeter of the impoundment. Alternatively, in areas where there is no ability to construct in ground containment facilities, fluid service providers may provide

onsite containment services using specially designed, large temporary above ground containment facilities. These impoundments, frac ponds and above ground storage facilities are specially designed for use in oil and gas operations and have no alternate utility.

Fluid service providers may also provide water treatment services with respect to the significant amount of water stored in these offsite containment facilities, including aeration, to prevent freezing of source water and minimize bacterial blooms that can result in the formation of hydrogen sulfide or other impurities, and biocides, which kill bacterial in stored water.

Fluid Services at the Wellsite

Once fresh water has been delivered to a large containment facility in the vicinity of the drilling activities, fluid service providers will assist oil and gas producers with (i) transporting the water to smaller, temporary storage facilities directly at the wellsite (which may be provided, designed and assembled by the fluid service providers) for use in completion, (ii) treating the water prior to it going downhole, and (iii) monitoring and testing the utilization of water throughout the transfer and pressure pumping process.

The transfer of water from large, offsite storage facilities (typically holding 4-5 million gallons of water) to smaller, temporary onsite storage facilities (typically fleets of connected frac tanks holding 20,000 gallons of water each) leverages the same equipment, personnel and expertise as overland pipe/hose transfer, but also provides additional complexities. Maintaining the appropriate volumes of fluids in storage facilities/impoundments is essential to a successful fracking operation, because in many cases the water is being removed from the storage facility at a flow-rate that exceeds the flow-rate at which water is entering the facility. At the same time, service personnel must monitor the hoses and pumps to ensure that the storage facility does not overflow while transferring water at a rate to most efficiently compensate for the asymmetrical flow rates. In order to ensure that there is sufficient water available for fracking operations at the drill site at all times, fluid service providers place personnel onsite to closely coordinate with the fracking contractor, to monitor water levels and ensure that water being utilized during a fracking stage is being replaced in real time. In addition to the onsite personnel utilized in monitoring the water usage and levels, fluid service providers may also provide electronic monitoring through the use of proprietary technology. These systems can provide hydrographic maps using SONAR remote control and GPS real-time data at inground storage facilities, as well as real time water chemistry reporting. Fluid service providers may also assist oil and gas producers by treating water "on the fly" at the wellsite, through utilizing mobile equipment that sterilizes water immediately before it is mixed with proppant to go down the wellbore, producing treated water free of bacteria, sulfides, particulates and insolubles. These water quality reporting and treating services require an in depth understanding of chemistry and downhole mixing considerations.

Well Testing

Finally, fluid service providers may also perform onsite fracturing flowback and production testing services. Well testing/flowback is a critical phase of the completion process because it allows experienced personnel to flow the well into specialized separation and measurement equipment to determine the economic potential of the well and related reservoir. Most states require such testing at various times in the life of the well. Wells that encounter oil

and gas will be flow tested using a temporary well testing equipment package, prior to installing permanent production equipment and facilities. The well testing/flowback gathers data that allows the oil and gas operator to justify further development, sizing of production equipment and planning the completion of the well. Once a well is placed on production, the well is tested periodically through a dedicated separator package to assist in calculating royalties and reserve data required by the government. Flowback data is extremely important in determining the economic value of a well, and the analysis derived from flow tests is used to calculate oil/gas reserves used by companies to report to state and federal agencies as well as to report to the SEC. Service providers will modify traditional well testing and hydraulic equipment so that it is customized for the geographic shale region in which a customer is operating. The engineering, modification and operation of such equipment requires highly-trained personnel and experience operating in challenging environments such as those with high temperature, high pressure, hydrogen sulfide, low pressure, high volume, and Arctic environments. The specialized equipment varies as to size and breadth of capacity depending on the shale region, but typically the equipment is comprised of:

- a choke manifold which throttles flow and reduces pressure to a manageable level
- 2-4 phase separators, which are high pressure vessels that separate oil, gas and water, along with level control mechanisms
- high pressure flowlines
- flow meters for oil and gas liquids
- sand separators, which are high pressure vessels used to separate sand and other particulates from water/oil
- tanks to hold produced fluids
- injection chemicals such as defoamers and emulsion breakers
- transfer pumps
- line heaters to warm up the flow to improve separation and prevent formation of methane hydrates that can shut down flow
- flare boom to burn off gas that cannot be captured
- various safety systems and emergency shutdown equipment
- logging cabin to run the data acquisition system
- additional downhole valves depending on situation
- trash catcher to collect and isolate debris from flow of well

This equipment is highly specialized and has no other viable commercial use other than oil and gas applications.

Fluid Services Downstream of the Wellsite.

Downstream of the wellsite, fluid service providers collect, transport, store, process, treat, and recycle or dispose of waste fluids associated with hydraulic fracturing. Dealing with waste fluids and flowback involves unique environmental issues and requires the application of specialized processes, plants and equipment.

A well completed using hydraulic fracturing uses millions of gallons of specially treated water. After the treated water is pumped into the well, a portion returns to the surface over time. The portion that returns to the surface during the first several months is referred to as "flowback". Flowback contains clays, chemical additives, dissolved metal ions and total dissolved solids. Following the flowback period, some of the remainder of the water used in the fracking process, along with pre-existing water in the formation, returns to the surface over the life of the well. This is referred to as "produced water" and it contains brine and other material from the formation. Produced water can comprise over 50% of the volume of total liquids produced from a well over time and over 95% of total oilfield waste by volume. These fluids must be continuously separated from a well's valuable oil and gas production, stored, transported away from the wellsite to be processed and purified prior to reuse in fracking, or disposed of properly in accordance with both federal and state law. Without this critical service, the oil and gas cannot be properly recovered and sold in the market.

Flowback and produced water are typically stored temporarily in tanks at the wellsite, picked up by tank trucks and transported away from the wellsite to a water treatment or disposal facility. Fluid service providers will schedule and dispatch tank trucks to the wellsite, and track shipments to ensure they arrive at the appropriate destination using approved routes. The waste fluids may then undergo a variety of processes: (i) processing to allow the resulting water to be discharged back into surface water sources, (ii) processing to allow the resulting water to be reused in fracking operations, or (iii) disposal by injection of the fluids into secure underground formations.

The engineering, design and operation of water treatment facilities that allow the resulting water to be discharged back into surface water sources requires an in-depth understanding of water chemistry, advanced water treatment plant design, civil engineering, hauling logistics and regulatory requirements. Significant technical resources including chemical, environmental and civil engineers, are required to properly design these more sophisticated water treatment plants. Technical considerations include metallurgy in the highly corrosive environment, influent water quality variability, product salt purity, discharge water quality requirements, and generated waste handling. Further, knowledgeable permitting personnel are required to understand the multiple agencies and their regulations involved in overseeing these types of facilities.

With respect to waste fluids subject to limited processing for reuse in further fracking operations, fluid service providers may utilize offsite facilities or onsite mobile platforms to treat flowback and produced water to go back into the fracking water supply. These operations similarly require the application of an in-depth understanding of water chemistry and associated efficacy with frack chemicals, downhole mixing considerations (e.g. long-term scale and corrosion forming

potential), facility location, hauling logistics and regulatory requirements, as well as sophisticated equipment designed specifically to treat flowback and produced water to be re-used in fracking. Provision of these services requires the use of experienced technical personnel, including chemical, environmental and civil engineers, as well as trained field labor that is knowledgeable in water chemistry, flow dynamics, equipment operation, and QA/QC tracking of influent and effluent.

With respect to waste fluids disposed of via injection into underground formations, fluid service providers are necessary to provide transportation of the fluids to those injection wells, as well as to construct, operate, and maintain the injection wells for fluid disposal services. Oftentimes, due to geographic and/or economic reasons, the fluid service provider transporting waste fluids for disposal may dispose fluids in wells operated by a third party service provider. The construction of saltwater disposal wells requires experienced technical personnel, including geologists and engineers, with in-depth understanding of subsurface geology, wellbore and facility construction to protect groundwater resources, zone injectivity, hauling logistics and regulatory requirements, as well as regulatory specialists to assist with reporting, permitting and compliance matters. Once designed, permitted, drilled and completed, the injection well requires trained field labor to operate the facility in a manner that continually manages injection pressures and flowrates at designed and permitted parameters. These disposal wells have no other viable commercial use other than for the disposition of oil and gas production waste fluids.

Contracting and Competition

In response to increasing industry demand, significant competition has arisen in the provision of water and frac fluid-related services. Large, independent, multi-basin water and frac-fluid service providers like Select compete with large national and international oilfield services companies that offer water-related services as part of a broad array of oilfield services. In addition, Select competes with smaller regional and mid-sized oilfield services companies, which may offer some or all of the services Select provides within their area of operations. Often times as well, Select competes against oilfield services companies that are specifically affiliated with oil and gas operators which provide them with a unique relationship advantage when competing for broad services. The competitive landscape within the industry is one of the factors impacting how oil and gas producers select their service providers.

While Select seeks to provide as broad of an array of water and frac fluid handling services to each customer as possible, oftentimes customers will engage Select to provide only a portion of the services Select offers with respect to any particular wellsite. For example, Select may bid to provide water sourcing, recycling and disposal services with respect to an oil and gas producer's drilling and completion activities within a specified geographic area, and only be engaged to provide water sourcing and transportation services. This outcome may be driven by a variety of commercial, economic or relationship factors, including that (i) many customers use different personnel to make procurement decisions with respect to different water and fluid-related services; (ii) other service companies operating in a geographic region may provide more competitive alternatives with respect to some categories of service than others; and (iii) for relationship reasons, many customers prefer to utilize more than one water and fluid-related service provider in the same geographic area. The fixed location of a disposal well will often dictate how economically

competitive that disposal well can be when compared to the location of other disposal wells in the area and in relation to the location of the oil well requiring fluid removal services. A disposal well that is located within a few miles from an oil well location will almost always be able to provide a more competitive disposal bid to an operator than the proposal coming from a disposal well that is located 25 miles from the well location. Thus, even though a company like Select can provide fresh water services to almost any well within its general service area, it may or may not be in a position to competitively provide disposal services on the same specific well it provides fresh water to due solely to geography. Likewise, Select may lose a bid to a competitor for fresh water sales but may have nearby disposal capacity that allows it to successfully procure the disposal business on that well. Every oil and gas well provides unique geographic considerations in the awarding of services.

Regardless of the reasons determining customer decisions, the outcome has been clear: despite a multi-year effort on the part of Select to convince its customers to permit Select to offer a "total water solutions" product, whereby Select provides all of a customer's water and frac-fluid needs during the life cycle of a well, customers have shown a strong preference to contract for individual services, often with a variety of providers based entirely on economic considerations. While in 2014 Select had revenue of $347 million in Water Solutions, $133 million in Well Testing and $206 million in Fluid Handling, Select would estimate that less than 5% of the combined revenue (of both services) would be generated on the same wellsite. While we do not have any third party data to confirm this, our experience suggests that each other independent full service frac fluid services provider faces the same commercial pressures to offer services on an individual basis.

Change to the Proposed Regulations

Given the commercial realities described under "Overview of the Frac Fluid Handling Industry," we believe the Proposed Regulations will generally result in two arbitrary and perhaps unintended results: (i) the fresh water sourcing and transportation activities of a partnership providing additional, highly specialized fluid related services at the wellsite with respect to such sourced water will generally not be qualifying activities, while the fresh water sourcing and transportation activities of a partnership providing similarly highly specialized fluid related services downstream of a wellsite with respect to such sourced water generally will be a qualifying activity; and (ii) the fresh water sourcing and transportation activities of companies engaged in the provision of a broad suite of frac fluid handling services within a geographic area—including the collection and disposal of frac fluids—will not be qualifying activities, due to customers' reluctance to hire companies to provide all of these services with respect to the same well.

These results are driven by the Proposed Regulations, specifically §1.7704-4(d)(ii), which provides, in pertinent part, that an activity is specialized if it involves personnel with specialized training and:

> "(ii) To the extent that the activity includes the sale, provision or use of property, either:
>
> ...

> (B) The property is used as an injectant to perform a section 7704(d)(1)(E) activity that is also commonly used outside of section 7704(d)(1)(E) activities (such as water, lubricants, and sand) and, as part of the activity, the partnership also collects and cleans, recycles, or otherwise disposes of the injectant after use in accordance with federal, state, or local regulations concerning waste products from mining or production activities (emphasis added)."

A plain reading of the purpose of the Proposed Regulations is that the IRS and Treasury intended to differentiate between companies merely engaged in the provision of fungible goods and those engaged in both the provision of distinct and specialized services utilizing that fungible good, which is a rationale we understand and endorse. We respectfully propose, however, that the IRS and Treasury consider modifying the text of §1.7704-4(d)(ii) to include one or both to the changes set out above. We believe these changes improve the Proposed Regulations, while preserving the appropriate limitations included in the Proposed Regulations.

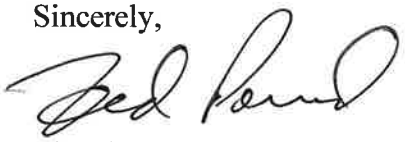
Change 1 provides that the provision of an injectant that is also commonly used outside of qualifying activities will satisfy the specialization requirement in §1.7704-4(d)(ii) if the partnership providing the injectant also provides other specialized services with respect to such injectant either at the wellsite or downstream of the wellsite. In their current form, the Proposed Regulations focus only on the provision of fresh water through water sourcing and transportation (the services upstream of the wellsite) and the provisions of collection, cleaning, recycling and disposal services (the services downstream of the wellsite), and do not consider the third crucial category of fluid services, those performed at the wellsite. As discussed in detail earlier in this letter, the fluid services performed at a wellsite, including intra-site water transfer, "on the fly" water treatment, real-time water monitoring and well testing, are each the kinds of services we believe the IRS and Treasury intend to consider qualifying activities. They utilize specialized personnel and equipment, involve significant service intensity and the presence of onsite personnel coordinating directly with fracking contractors, and they are essential to the production of oil and gas. Viewed from this perspective, we believe distinguishing between these services and fluid services provided downstream of the wellsite is arbitrary and unnecessary to accomplish the IRS and Treasury's goals.

Change 2 addresses the issues raised by the fact that it is rare for the same service company to provide both water supply and water disposal services at the same wellsite. We propose that, instead of requiring that the provision of a fungible injectant to a wellsite be qualifying only if **that injectant** is also collected and cleaned, recycled or otherwise disposed of by the same partnership, the IRS and Treasury broaden the test from what appears to be a well-by-well basis to a basin-by-basin basis. As described earlier in this letter, a partnership is rarely able to successfully contract with third party customers to provide fluid services both upstream and downstream of a given wellsite, making the specialization requirement impossible to satisfy for independent fluid service companies with respect to any material portion of their business, regardless of the breadth of services they offer. Modified as we propose, the specialization requirement would permit water sourcing activities of partnerships to be qualifying if that partnership is actively engaged in providing downstream fluid services within the same geographic region.

The Proposed Regulations, as modified by our comments set forth above, will be carefully tailored to ensure that the provision of fresh water to a wellsite to be used in hydraulic fracturing will not be a qualifying activity without the service provider also either (i) performing intensive, specialized services with respect to that water at the wellsite or (ii) performing intensive, specialized services downstream of the wellsite within the same geographic region to the same customers. We believe the Proposed Regulations, as modified by our comments, are carefully tailored to be entirely consistent with the IRS and Treasury's view in the preamble to the Proposed Regulations that "intrinsic activities constitute active support of section 7704(d)(1)(E) activities, and not merely the supply of goods."

We appreciate the opportunity to provide the comments set forth in this letter, and would be pleased to provide any additional information at the IRS or Treasury's request.

Sincerely,



Theodore F. Pound
Vice President and General Counsel
Select Energy Services, LLC