Court orders Alberta's Minister of Energy to return $20 million in unlawfully collected royalties

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In *Taylor Processing Inc v Alberta (Minister of Energy)*, 2023 ABKB 64, the Court of King's Bench of Alberta quashed three decisions made by the Alberta Minister of Energy (Alberta Energy) which had resulted in the Province of Alberta unlawfully collecting over $20 million in royalties from Nova Chemicals Corporation (Nova), and directed that those funds be returned to Nova, with interest.

Background

Taylor Processing Inc. was the operator of the Harmattan Gas Processing Plant (the Harmattan Plant) until Jan. 1, 2016, when AltaGas Ltd. became the operator (Taylor and AltaGas will collectively be referred to as Taylor).

The Harmattan Plant is unique in that it processes both raw gas and co-stream gas. Raw gas is delivered from upstream field facilities to be processed at the Harmattan Plant, at which time it becomes subject to payment of Crown royalties pursuant to the *Mines and Minerals Act* (the *MMA*)[1] and its regulations, including the *Natural Gas Royalty Regulation, 2009* (*2009 Royalty Regulation*).[2] Co-stream gas has already been processed and subjected to payment of Crown royalties before it enters the Harmattan Plant to be processed further for the purposes of extracting natural gas liquids.

Pursuant to sections 8 and 9 of the *2009 Royalty Regulation*, Alberta Energy is only entitled to collect royalties **once** on the same gas volume. Accordingly, Taylor separately reports raw gas and co-stream gas volumes processed at the Harmattan Plant, net of shrinkage, to separate accounts in Petrinex. Taylor reports the co-stream gas volumes to a special "royalty-exempt" account called WG99999 (the WG Account) to ensure that no additional royalties are charged on those volumes.

Shrinkage is the reduction in gas volumes caused by, among other things, venting, flaring, or the use of gas for fuel to power the processing equipment. To calculate the shrinkage attributable to each of the raw gas and co-stream gas volumes, Taylor uses a Fuel Allocation Procedure that reflects the specific operations at the Harmattan Plant. Notably, the Fuel Allocation Procedure recognizes that the co-stream gas requires

significantly less fuel gas for processing, given that co-stream gas has already been processed prior to entering the Harmattan Plant, and therefore does not pass through the equipment required to initially process the raw gas.

Between 2012 and 2016, Alberta Energy did not raise any concerns with Taylor's volumetric reporting of co-stream gas to the WG Account. In April 2016, Alberta Energy decided to conduct its own calculations of raw gas and co-stream gas volumes processed at the Harmattan Plant by applying shrinkage rates that it calculated using a pro-rata allocation of fuel gas between the raw gas and co-stream gas volumes (the Pro-rata Allocation). The ultimate effect of the Pro-rata Allocation was to increase the royalties owing to Alberta Energy. Increasing the volume of fuel gas attributable to the processing of co-stream gas correspondingly decreased the amount of co-stream gas that could be reported to the royalty-exempt WG Account and increased the amount of raw gas that must be reported to a royalty-payable Petrinex account.

In Nov. 2016, Alberta Energy issued a Gas Royalty Operations Information Bulletin (the IB) and an accompanying Appendix B titled "WG99999 General Business Rules" (the IB Rules) that purported to govern, among other things, reporting to the WG Account. The IB Rules purported to allow Alberta Energy to calculate shrinkage at a "predetermined rate" where it determined that shrinkage was not being fairly represented.

Despite objections from Taylor, on Nov. 16, 2018, Alberta Energy issued a Notice of Determination (the First NOD) advising that it had found "reporting discrepancies" in Taylor's reporting to the WG Account for each of the 2013-2015 production years, and it would apply caps to the volumes that Taylor could report to the WG Account and charge royalties on any volumes exceeding the caps. The caps were calculated pursuant to the IB Bulletin and using the Pro-rata Allocation. Between November 2018 and February 2019, Alberta Energy issued invoices to Nova for royalties in the amount of $19,530,379.77 for volumes that exceeded the caps in each of the 2013 – 2016 production years (the 2013-2016 Invoice).

Shortly thereafter, unbeknownst to Taylor, Alberta Energy received the assessment of Taylor's Fuel Allocation Procedure that it had requested from the Alberta Energy Regulator (the AER). The AER confirmed it was satisfied with the accuracy of Taylor's Fuel Allocation Procedure.

Taylor and Nova filed objections to the First NOD with the Director of Dispute Resolution (the DDR). To do so, Nova was required to first pay the 2013 – 2016 Invoice. Pending the DDR's review of those objections, Taylor filed an application for judicial review of the First NOD.

On March 27, 2020, the DDR issued its decision which upheld the First NOD (the DDR Decision). Taylor and Nova each sought judicial review of the DDR Decision.

On Oct. 27, 2020, Alberta Energy issued a second Notice of Determination (the Second NOD) to Taylor that was identical in substance to the First NOD but related to the 2017 production year. Alberta Energy subsequently issued invoices to Nova for royalties in the amount of $668,958.86 owing for volumes that exceeded the caps in the 2017 production year (the 2017 Invoice).

Taylor and Nova both filed objections to the Second NOD with the DDR, but the DDR decided to hold those objections in abeyance pending the Court's decision on the judicial reviews of the First NOD and the DDR Decision. Consequently, Taylor and Nova filed applications for judicial review of the Second NOD.

Decision

All parties agreed that the applicable standard of review of the First NOD, the DDR Decision and the Second NOD (together, the Decisions) was reasonableness.[3]

The Court found that the Decisions were unreasonable for five key reasons:

1. **Alberta Energy issued inadequate reasons**: The Court held that, in relation to the First NOD and the Second NOD, Alberta Energy failed in its duty to provide adequate reasons that explained, among other things: (i) what "reporting discrepancies" it had identified; (ii) how it had identified those "discrepancies"; and (iii) what statutory authority it had to impose the caps.
2. **Alberta Energy improperly reversed the onus**: The Court held that, while Alberta Energy has discretion pursuant to section 37 of the *MMA* and section 16(2) of the *2009 Royalty Regulation* to recalculate royalties, Alberta Energy has the evidentiary onus to prove that the statutory pre-conditions prescribed in those sections were met. In this case, Alberta Energy failed to identify any evidentiary basis to establish that Taylor had engaged in an act that "artificially or unduly reduced the amount of royalties owing" (section 37 of the *MMA*) or that Taylor had submitted incorrect information to, or omitted information from, Petrinex, that may have affected the calculation of royalties (section 16(2) of the *2009 Royalty Regulation*). Instead, Alberta Energy, and particularly the DDR, improperly shifted the evidentiary onus to Taylor when it found that it was "not convinced" that Taylor and Nova had provided "sufficient evidence" to establish that Taylor's reporting in Petrinex fairly represented shrinkage.
3. **Alberta Energy failed to consider relevant evidence**: The Court held that Alberta Energy's decision to render the First NOD prior to receiving the AER's assessment of Taylor's Fuel Allocation Procedure, and its failure to provide the AER's assessment to the DDR prior to it issuing the DDR Decision, rendered the Decisions unreasonable given that the AER's assessment was "critical evidence" that "should effectively have satisfied any doubts" Alberta Energy had about the Fuel Allocation Procedure.
4. **Alberta Energy exceeded its jurisdiction**: The Court held that Alberta Energy has authority to issue non-statutory instruments, such as the IB and IB Rules, to inform and guide regulated parties and allow for more effective enforcement of the regulatory scheme. However, these non-statutory instruments do not have the force of law and cannot confer authority to Alberta Energy that exceeds the jurisdiction conferred to it under the *MMA* and its associated regulations, and to the extent they do, they are unenforceable. The Court held that the authority Alberta Energy conferred to itself in the IB and IB Rules to impose shrinkage at pre-determined rates was inconsistent with, and exceeded, Alberta Energy's authority under section 37 of the *MMA*. Given that the Decisions were based on the IB and IB Rules, the Decisions were unreasonable.
5. **Alberta Energy made calculation errors**: Given a system limitation in Petrinex, in the First NOD and the 2013-2016 Invoices, Alberta Energy charged Nova royalties on *all* gas volumes for the full month in which a cap was reached rather

than only on those volumes that exceeded the caps. Taylor and Nova raised this calculation error in their objections, but the DDR never addressed it in the DDR Decision, which rendered the DDR Decision unreasonable. The parties ultimately implemented a workaround to correct this error in the Second NOD and the 2017 Invoice, but Alberta Energy never went back and applied the workaround to the First NOD and the 2013-2016 Invoices. The Court found this resulted in Alberta Energy charging excessive royalties and was unreasonable.

Given these errors, the Court quashed each of the Decisions and directed Alberta Energy to repay the sum of $20,196,428.27 to Nova, with interest calculated in accordance with the *2009 Royalty Regulation*. The Court acknowledged that the threshold for quashing an administrative decision without remitting back to the original decision maker is high, but determined that remitting the Decisions back to Alberta Energy and the DDR would be "pointless" given that Alberta Energy had failed to establish any evidentiary basis for imposing the caps in the first instance, and the AER's assessment conclusively proved[4] that Taylor's reporting in Petrinex in accordance with the Fuel Allocation Procedure was appropriate.

Takeaways

In the words of Justice Malik, this decision makes clear that Alberta Energy "is entitled to collect only those royalties that are lawfully due – no more, no less and, even then, only in accordance with what is permitted under the *MMA*". Alberta Energy's discretionary authority to recalculate royalties pursuant to the *MMA* and its associated regulations must be exercised reasonably, on a proper evidentiary foundation, and in a manner that is consistent with its statutory jurisdiction.

In addition, given the Court's finding that the portion of the IB and IB Rules that purportedly allows Alberta Energy to calculate and impose shrinkage at pre-determined rates was unenforceable, oil and gas participants who report volumes to the WG Account should consider reviewing their royalty invoices to ensure that they have been properly calculated.

The authors of this article acted as counsel for Nova Chemicals Corporation.

[1] RSA 2000, c M-17.

[2] Alta Reg 221/2008.

[3] Per *Canada (Minister of Citizenship and Immigration) v Vavilov*, 2019 SCC 65.

[4] At least for the production years 2013-2017.

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