Holland & Hart



Rosario Hecht Domínguez (Doriott)

Partner
203.513.3209
Denver
RDHechtDominguez@hollandhart.com

Significant Industry Victory in Federal Offshore Royalty Dispute

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In a recent 44-page ruling, the Interior Board of Land Appeals (Board) vacated in full, without remand, an Order to Perform Restructured Accounting and Pay (Order) issued by the Office of Natural Resources Revenue (ONRR) that would have required an offshore operator to recalculate and repay more than $20 million in federal royalties across over 40 properties in the Gulf of Mexico (Gulf of America). The decision is a significant victory for industry in a long-running federal offshore royalty dispute.

Broader Legal and Industry Impact

The decision reinforces the fundamental principle that federal agencies must operate within the bounds of their authority, even when pursuing revenue collection. The Board drew a clear line: ONRR cannot issue audit-style orders without procedural rigor, and it cannot sidestep statutory limits that protect taxpayers from government overreach.

Importantly, this decision establishes that due process matters, especially in complex royalty disputes where millions of dollars and years of compliance obligations are at stake. The Board's ruling makes clear that agencies cannot rush through enforcement actions without following established procedural safeguards, even when under pressure to collect revenue.

The Board's rulings will be of particular interest to operators facing Orders to Perform Restructured Accounting and Pay or other post-refund enforcement actions, especially in cases involving previously approved refunds, offshore operations and transportation allowances, or long lookback periods:

- Sweeping enforcement demands must be grounded in lawful, procedurally sound processes.
- Audit orders must comply with GAGAS and allow meaningful input from the audited party;
- Tolling agreements cannot retroactively extend ONRR's limitations periods; and
- Operators should proactively identify and document refund opportunities as part of any audit process.

Holland & Hart Partner Rosario Hecht Domínguez served as lead counsel.*

Case Background

Between 2016 and 2020, the company discovered it had significantly overpaid royalties from August 2010 through December 2016 due to its failure to claim all allowable transportation deductions – deductions that may be taken under federal regulations for reasonable, actual costs incurred in transporting oil and gas to the point of sale.

The company filed eight refund requests totaling over $19.5 million in principal. ONRR approved and paid the first five but subsequently initiated an audit of all eight refund requests, asserting concerns with the company's transportation methodology.

Government's Overreach

In July 2020, ONRR issued the Order. It went far beyond rejecting the remaining refund requests. ONRR attempted to:

- Claw back previously approved refunds and demand the company repay millions,
- Impose ONRR's preferred valuation methodology retroactively,
- Require the company to recalculate transportation allowances across decades of production, and
- Lay the foundation for potential civil penalties.

The Order's massive re-accounting demands applied to more than 40 offshore properties, threatening significant financial and administrative burdens.

Strategic Legal Arguments and Board Ruling

Led by Rosario Doriott Domínguez, the legal team mounted a multi-pronged defense addressing both procedural and substantive flaws in ONRR's methodology and its enforcement action. The Board agreed with several key arguments, delivering a decisive rebuke of ONRR's process.

- Failure to Comply with Government Auditing Standards (GAGAS): The Board held that ONRR violated mandatory Generally Accepted Government Auditing Standards by failing to seek, evaluate, or respond to the company's views prior to issuing its Order. Citing GAGAS, the Board emphasized that an agency must meaningfully consider the audited entity's response before finalizing findings or demands. The Board underscored that lessees are entitled to fair process before being subjected to significant recalculations and potential penalties. The absence of this step rendered the audit – and the resulting Order – procedurally defective.

Because the Board had “not previously articulated how this particular requirement of GAGAS might apply to orders for a restructured accounting,” it explained, “In our view, ONRR cannot rely on procedural steps after issuing an order to perform a restructured accounting (for example, during the 'closure phase') to demonstrate that the order itself is based on a GAGAS-compliant audit. … Although the GAGAS requirement

of soliciting and reporting the views of the audited entity applies on its face to the 'audit report,' we conclude that on the facts here, ONRR was required to meet that requirement before issuing the Order to Perform."

- Statute of Limitations and Tolling: In a decision of apparent first impression, the Board also held that ONRR cannot revive time-barred periods through tolling agreements. Because ONRR did not act within the statutory limitations period, its authority to order restructured accounting for certain sales months had expired.

  "On this point, we agree with [the company]. Although ONRR cites some cases in which courts have bound parties to their agreement to toll a statute of limitations retroactively, Congress here expressly limited the effectiveness of tolling agreements to those 'executed during the limitation period," specifically barring ONRR from ordering restructured accounting for production prior to April 2011.

  This holding reinforces that tolling agreements do not permit ONRR to sidestep binding legal deadlines.
- Refund Adjustment Periods: The Board also agreed that the company's latest refund request, submitted in April 2020 and seeking a refund of royalties that became due as early as August 2010, was still timely because it was made, as the relevant statute permits, "during an audit of the period which includes the production month for which the adjustment is being made."

The Board fully vacated, without remand, the Order and the Director's Decision affirming the Order. Should ONRR issue a new order, it remains time-barred from making any demands with respect to those periods prior to April 2011. The Board remanded the remaining three refund requests to ONRR for further substantive action consistent with the Board's procedural rulings.

*Rosario Hecht Domínguez served as lead counsel in this matter while a Partner at Ryan Law Firm. The decision, issued after she joined Holland & Hart, is based on briefing submitted during her tenure at Ryan.

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