

BLUE DOLPHIN ENERGY CO
Form 10-K
March 30, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2011

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____.

Commission File No. 0-15905

BLUE DOLPHIN ENERGY COMPANY

(Exact name of registrant as specified in its charter)

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Delaware **73-1268729**
State or other jurisdiction of **(I.R.S. Employer**
incorporation or organization **Identification No.)**
801 Travis Street, Suite 2100
Houston, Texas **77002**
(Address of principal executive offices) **(Zip Code)**
(713) 568-4725

Registrant's telephone number, including area code

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, par value \$0.01 per share	OTCQX

Securities registered pursuant to Section 12(g) of the Act:

(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Act.

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller Reporting Company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No

Aggregate market value of voting stock held by non-affiliates of the registrant as of June 30, 2011 was approximately \$3,436,139 million based on the closing price of \$3.01 per share on the NASDAQ Capital Market.

Number of shares of Common Stock outstanding as of March 30, 2012

10,533,070

DOCUMENTS INCORPORATED BY REFERENCE

Certain sections of the registrant's definitive proxy statement for its 2012 Annual Meeting of Stockholders, which is to be filed with the Securities and Exchange Commission pursuant to Regulation 14A, under the Securities and Exchange Act of 1934 within 120 days of the registrant's fiscal year ended December 31, 2011, are incorporated by reference in Part III of this report.

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CAUTIONARY STATEMENTS RELEVANT TO FORWARD-LOOKING INFORMATION

FOR THE PURPOSE OF SAFE HARBOR AS DEFINED IN THE

SECURITIES ACT OF 1933, AS AMENDED,

AND THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED

This annual report on Form 10-K of Blue Dolphin Energy Company (referred to herein, with its predecessors and subsidiaries, as Blue Dolphin, we, us and our) contains forward-looking statements that are based on management's current expectations, estimates and projections related to Blue Dolphin's operations, the energy industry and other-related industries. Words such as expect, plan, believe, anticipate, project, estimate, similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and are subject to certain risks, uncertainties and other factors, some of which are beyond Blue Dolphin's control and are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or forecasted in such forward-looking statements. It is not possible to identify all of these risks, uncertainties or assumptions. Among the important factors that could cause actual results to differ materially from those in the forward-looking statements are: realization of anticipated benefits of acquired operations; volatility of refining margins; market acceptance of our refined products; performance of third-party operators; potential downtime for maintenance and repairs; environmental costs and liabilities associated with our operations; related party transactions and ownership; continued declines in throughput volumes and production rates from our U.S. Gulf of Mexico leasehold properties; our ability to offset revenue from one key customer; our ability to generate sufficient funds from operations or obtain financing from other sources; changing crude oil or natural gas prices; changes in reserve estimates; local and regional events that may negatively affect our assets; competition from larger companies; acquisition opportunities; operating hazards; insurance coverage limitations; retention and recruitment of key employees; compliance with environmental and other regulations; the effects of greenhouse gas emissions regulation; and the factors set forth under the heading Risk Factors in Item 1A of this report, as well as disclosures made under the caption Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 7 of this report. Other unpredictable or unknown factors not discussed in this report could also have material adverse effects on forward-looking statements. The reader should not place undue reliance on these forward-looking statements, which speak only as of the date of this report. Unless legally required, Blue Dolphin undertakes no obligation to publicly update any forward-looking statements, whether as a result of new information, future events or otherwise.

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PART I

ITEM 1. BUSINESS

On February 15 2012, we acquired Lazarus Energy, LLC, a Delaware limited liability company (LE) pursuant to a merger that has the potential to expand the size and scope of our business (the Acquisition). Except as otherwise noted, the description of our business contained in this Item 1 refers to the business of Blue Dolphin and its consolidated subsidiaries on a pre-acquisition basis. Further, the financial results contained in this report, which is for the twelve month period ended December 31, 2011, do not include any results from our crude oil and condensate processing operations which we acquired as part of the Acquisition.

The Company

Blue Dolphin, a Delaware corporation formed in 1986, manages the investments and conducts the operations of its wholly-owned subsidiaries. At December 31, 2011, Blue Dolphin operated two lines of business through its subsidiaries: (i) pipeline transportation services to producers/shippers and (ii) oil and gas exploration and production.

At December 31, 2011, Blue Dolphin's subsidiaries were as follows:

Blue Dolphin Pipe Line Company, a Delaware corporation (BDPL) (pipeline operations);

Blue Dolphin Petroleum Company, a Delaware corporation (BDPC) (exploration and production activities);

Blue Dolphin Exploration Company, a Delaware corporation (inactive);

Blue Dolphin Services Co., a Texas corporation (administrative services); and

Petroport, Inc., a Delaware corporation (inactive).

Our principal executive office is located at 801 Travis Street, Suite 2100, Houston, Texas, 77002, and our telephone number is (713) 568-4725. At December 31, 2011, we had five (5) full-time employees at locations in Freeport and Houston, Texas and regularly used the services of one (1) consultant. Our common stock, par value \$0.01 per share (Common Stock) is publicly traded on the OTCQX U.S. Premier under the ticker symbol BDCO. Our corporate website address is <http://www.blue-dolphin.com>.

Certain terms that are commonly used in the oil and gas industry, including terms that define our rights and obligations with respect to our interests in properties, are defined in the Glossary of Certain Oil and Gas Terms of this report.

Recent Developments

Acquisition of Lazarus Energy, LLC (LE). As previously reported, we entered into a Purchase and Sale Agreement (the PSA) with Lazarus Energy Holdings, LLC, a Delaware limited liability company (LEH) and LEH's wholly-owned subsidiaries to acquire one hundred percent (100%) of the issued and outstanding membership interests of LE, (the Acquisition). LE's primary asset is a 56-acre crude oil processing facility, located near Nixon, Texas (the Nixon Facility). On February 15, 2012, we consummated the Acquisition and issued, in reliance on the exemption provided by Section 4(2) of the Securities Act 8,393,560 shares of Common Stock, subject to anti-dilution adjustments, to LEH as consideration for LE (the Original BDEC Shares). Additionally, on February 21, 2012, pursuant to the anti-dilution provisions contained in the PSA, and in reliance on the exemption provided by Section 4(2) of the Securities Act, we issued 32,896 shares of Common Stock to LEH (the Anti-Dilution Shares) and together with the Original BDEC Shares, the BDEC Shares) effective February 15, 2012. As a result of our issuance of

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the BDEC Shares, LEH currently owns eighty percent (80%) of our issued and outstanding Common Stock. The issuance of the BDEC Shares to LEH resulted in a change in control of Blue

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Dolphin. Further, pursuant to the terms of the PSA, the composition of Blue Dolphin's Board of Directors (the Board) and management changed. The Acquisition will be accounted for as a reverse acquisition in which LE is deemed to be the Acquirer and accounting predecessor and Blue Dolphin is deemed to be the Acquiree. Following the Acquisition, the combined company will continue to operate under the name Blue Dolphin Energy Company. See our Current Reports on Form 8-K filed with the Securities and Exchange Commission on July 22, 2011, February 2, 2012, February 21, 2012, February 28, 2012 and March 14, 2012, for more information on the Acquisition.

Management of Blue Dolphin's Assets. As part of LEH's assignment of the membership interests of LE, on February 15, 2012, Blue Dolphin, LE and LEH entered into a Management Agreement (the Management Agreement) pursuant to which LEH agreed to manage and operate the Nixon Facility and Blue Dolphin's other operations (collectively, the Services). Pursuant to the terms of the Management Agreement, LEH shall retain, as compensation for the Services, the right to receive (i) weekly payments based on revenues from the sale of diesel blend stocks processed by the Nixon Facility not to exceed \$750,000 per month, (ii) reimbursement for certain accounting costs related to the preparation of LE's financial statements not to exceed \$50,000 per month, (iii) \$0.25 for each barrel processed at the Nixon Facility during the term of the Management Agreement, up to a maximum quantity of 10,000 barrels per day determined on a monthly basis, and (iv) \$2.50 for each barrel processed at the Nixon Facility during the term of the Management Agreement, to the extent the quantity exceeds 10,000 barrels per day determined on a monthly basis. We further agreed to reimburse LEH at cost for all reasonable expenses incurred while performing the services. All compensation owed to LEH under the Management Agreement is to be paid to LEH within 30 days of the end of each calendar month. The Management Agreement expires upon the earliest to occur of (a) the date of the termination of the Joint Marketing Agreement between LE and a third party dated August 12, 2011, which has an initial term of three years and year-to-year renewals at the option of either party thereafter, (b) August 12, 2014, or (c) upon written notice of either party to the Management Agreement of a material breach of the Management Agreement by the other party. If the Management Agreement is renewed after the expiration of its initial term, then it will thereafter be reviewed on an annual basis by the Board and may be terminated if the Board determines that the Management Agreement is no longer in the best interest of Blue Dolphin.

LEH owns approximately eighty percent (80%) of our issued and outstanding Common Stock. Jonathan P. Carroll, our Chief Executive Officer, President, Assistant Treasurer and Secretary, and Tommy L. Byrd, our interim Chief Financial Officer, Treasurer and Assistant Secretary, are also a member and Chief Financial Officer, respectively, of LEH and, as a result may, under certain circumstances, have interests that differ from or conflict with our interests. Further, pursuant to the Management Agreement, LEH manages and operates the Nixon Facility and Blue Dolphin's other operations. As a result of their relationship with LEH, Messrs. Carroll and Byrd may experience conflicts of interest in the execution of their duties on behalf of Blue Dolphin including with respect to the Management Agreement. See Part I, Item 1A. Risk Factors of this report related to related party transactions.

Lazarus Energy Development, LLC (LED) Acquisition. Pursuant to the terms of the PSA, we had the option to acquire all of the issued and outstanding membership interests of LED, a Delaware limited liability company and a wholly-owned subsidiary of LEH. Among other assets, LED holds approximately 46 acres of real property adjacent to the Nixon Facility. On February 7, 2012, we paid LEH a refundable deposit of approximately \$183,000 to exercise the option and as partial payment of the purchase price for LED. As part of the acquisition, we agreed to assume an LED loan in the amount of \$1.5 million collateralized by the real property adjacent to the Nixon Facility. We expect to complete the acquisition of LED from LEH in the second quarter of 2012 for a total purchase price of approximately \$1.68 million. See Part I, Item 1A. Risk Factors of this report related to acquisition opportunities, as well as Liquidity and Capital Resources under Part II, Item 7 of this report for additional information on how we plan to fund the acquisition of LED.

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Nasdaq Listing. On May 27, 2011, we received a letter from Nasdaq's Listing Qualifications Department (the "Staff") notifying us that our stockholders' equity had fallen below the \$2.5 million minimum requirement for continued listing as set forth in Marketplace Rule 5550(b) (the "Stockholders' Equity Requirement"). As a result of meeting the Stockholders' Equity Requirement by a relatively slim margin related to a previous deficiency, a Nasdaq Hearings Panel (the "Panel") placed us on a one year monitoring period (the "Panel Monitoring Period"). Receipt of Staff's May 27, 2011 letter created an additional deficiency for the Panel's consideration. We submitted a plan to meet the Stockholders' Equity Requirement to the Panel on May 31, 2011. On June 9, 2011, we were notified by the Panel that our Common Stock would be delisted as a result of no longer meeting the Stockholders' Equity Requirement. Although we filed an appeal of the Panel's decision to the Nasdaq Listing and Hearing Review Council (the "Review Council"), our Common Stock ceased trading on The Nasdaq Capital Market effective with the open of business on Monday, June 13, 2011, and began trading on the OTCQB Marketplace under the same ticker symbol immediately following suspension of trading on Nasdaq.

On July 21, 2011, we submitted a compliance plan to the Review Council based, in part, on the pending cash sale of certain of our assets to Sunoco Partners Marketing & Terminals L.P. ("Sunoco"), which would increase stockholders' equity. On August 30, 2011, following the consummation of the transaction with Sunoco, we received notification from the Panel, pursuant to instructions received from the Review Council, that: (i) our Common Stock would resume trading on the Nasdaq Capital Market effective September 1, 2011 before the open of the markets and (ii) our continued compliance with the Stockholders' Equity Requirement was subject to a Panel Monitoring Period.

On January 3, 2012, we were notified by Staff that we failed to hold an annual meeting of shareholders, solicit proxies and provide proxy statements to Nasdaq as set forth in Marketplace Rule 5620(a) and 5620(b) (the "Annual Meeting Requirement"). As we were under a Panel Monitoring Period, receipt of Staff's January 3, 2012 letter created an additional deficiency for the Panel's consideration. On January 18, 2012, we submitted a compliance plan to the Panel based on our then scheduled 2011 Annual Meeting of Stockholders (the "Annual Meeting") to be held on January 27, 2012. The definitive proxy statement for the Annual Meeting was filed with the Securities and Exchange Commission (the "SEC") on December 28, 2011. The Annual Meeting was delayed beyond the 2011 calendar year as a result of the Acquisition, certain parameters of which required stockholder approval.

On December 8, 2011, the Staff determined that the Acquisition qualified as a "Business Combination" and that, pursuant to Marketplace Rule 5110(a), we would have to apply and be approved for initial listing of our Common Stock on the Nasdaq Capital Market on a post-Acquisition basis (the "New Nasdaq Listing Application"). If closing of the Acquisition occurred prior to us receiving approval of the New Nasdaq Listing Application, our Common Stock was subject to delisting pursuant to Marketplace Rule 5110(a). We submitted the New Nasdaq Listing Application to the Staff on December 13, 2011 and have worked with the Staff to provide additional information as requested. On February 15, 2012, we consummated the Acquisition. On February 24, 2012, we received notification that the Panel had determined to delist our Common Stock from the Nasdaq Capital Market and suspend trading in the shares effective at the open of business on February 28, 2012. Simultaneous with the Nasdaq delisting, our Common Stock began trading on the OTCQX U.S. Premier tier of the OTC Markets under the ticker symbol "BDCO". We plan to continue to file with the SEC any and all reports as may be required under the Securities and Exchange Act of 1934, as amended (the "Exchange Act") following the delisting. Although we are attempting to relist our Common Stock on the Nasdaq Capital Market, there can be no assurance that the Staff will approve the New Nasdaq Listing Application.

Disposition of Pipeline Assets. On August 3, 2011, BDPL, a wholly-owned subsidiary of Blue Dolphin completed the sale of its eighty-three and one-third percent (83¹/₃%) interest in the Buccaneer Pipeline to Sunoco for net proceeds of approximately \$3.6 million in cash. The Buccaneer Pipeline is located onshore in Brazoria County, Texas. Assets in the sale also included above ground storage tanks, a barge loading terminal, a pumping station and related equipment. As a result of the sale, Blue Dolphin no longer handles the onshore transportation and storage of oil.

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The standard refining process is complex and involves numerous stages to create final products. By contrast, the Nixon Facility's operations are only involved in the first stage of the refining process. The Nixon Facility, which has an operating capacity of approximately 15,000 barrels of oil per day, consists of tankage, a distillation unit, recovery facilities and the necessary utility systems. As a topping unit, the Nixon Facility separates input crude oil and condensate into diesel and jet fuel for sale into nearby markets, as well as naphtha and atmospheric gasoil for sale to nearby refineries for further processing. Input crude oil and condensate is currently purchased on the spot market (month to month) and delivered by truck. However, the facility also has the ability to receive crude oil and condensate via pipeline. Refined products are currently sold and delivered by truck. The Nixon Facility's assets are held by LE. Financial results contained in this report do not include those of our Nixon Facility's operations.

Pipeline Operations

We gather and transport oil and natural gas for producers/shippers operating offshore in the vicinity of our pipelines in the U.S. Gulf of Mexico and charge a fee based on anticipated throughput volumes. We handle the sale of gas through a chemical plant complex and intrastate pipeline system tie-in. All of our pipeline assets are held by and the business conducted by BDPL. Unless otherwise stated herein, all gas liquid volumes transported are attributable to production from third-party producers/shippers.

Pipeline Assets. The following provides a summary of our pipeline segments:

Pipeline Segment	Market	Ownership	Miles of Pipeline	Capacity (MMcf/d)	Average Throughput (MMcf/d)		
					2011	2010	2009
BDPS	U.S. Gulf of Mexico	83.3%	38	180	4.4	13.7	15.5
GA 350	U.S. Gulf of Mexico	83.3%	13	65	13.6	17.4	19.0
Omega	U.S. Gulf of Mexico	83.3%	18	110			

Blue Dolphin Pipeline System (BDPS) The BDPS spans approximately 38 miles and runs from Galveston Area Block 288 offshore to our onshore facilities and the Dow Chemical Plant Complex in Freeport, Texas. The BDPS has an aggregate capacity of approximately 180 MMcf of gas and 7,000 Bbbls of crude oil and condensate per day. The BDPS is currently transporting an aggregate of approximately 3 MMcf of gas per day, which represents 1% of throughput capacity.

The BDPS includes: (i) approximately 188 acres of land in Brazoria County, Texas where the Blue Dolphin Pipeline comes ashore and where the BDPS onshore facilities, pipeline easements and rights-of-way are located, (ii) an offshore platform and (iii) the Blue Dolphin Pipeline. The BDPS gathers and transports oil and gas from various offshore fields in the Galveston Area of the U.S. Gulf of Mexico to our onshore facilities located in Freeport, Texas. The oil is processed, stored and sold by a third-party. The gas is transported to the Dow Chemical Plant Complex and a major intrastate pipeline system with further downstream tie-ins to other intrastate and interstate pipeline systems and end users.

Galveston Area Block 350 Pipeline (the GA 350) The GA 350 is an 8-inch, 13 mile offshore pipeline extending from Galveston Area Block 350 to an interconnect with a transmission pipeline in Galveston Area Block 391 located approximately 14 miles south of the Blue Dolphin Pipeline. Current system capacity on the GA 350 is 65 MMcf of gas per day. The GA 350 is currently transporting an aggregate of approximately 9 MMcf of gas per day, which represents 14% of throughput capacity.

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Omega Pipeline (the Omega) The Omega originates in the High Island Area, East Addition Block A-173 and extends to West Cameron Block 342, where it was previously connected to the High Island Offshore System. The Omega is currently inactive. Reactivation of the Omega is dependent upon future drilling activity in the vicinity and successfully attracting producer/shippers to the system.

Exploration and Production

Our oil and gas exploration and production activities include leasehold interests in properties located in the U.S. Gulf of Mexico and the North Sumatra Basin offshore Indonesia. Our leasehold interests, which are held in and the operations conducted by BDPC, are subject to royalty and overriding royalty interests. We evaluate and manage oil and gas properties giving consideration to geography, reserve life and hydrocarbon mix based on seismic and other data.

During the year ended December 31, 2011, our unamortized cost exceeded the present value of estimated future net revenues, and we recorded an impairment to our U.S. Gulf of Mexico oil and gas properties of \$252,706. Although our U.S. Gulf of Mexico oil and gas properties may continue to operate over the next twelve to eighteen months, we expect the operating costs to exceed gross revenues based on current reserves and net cash flow estimates making these properties uneconomic.

Exploration and Production Assets. The following provides a summary of our oil and gas properties:

Field	Operator	Interest
Indonesia:		
North Sumatra Basin-Langsa Field	Blue Sky Langsa, Ltd.	7% WI, 5.20625% NRI (+ reversion)
U.S. Gulf of Mexico:		
High Island Block 115	Rooster Petroleum, LLC	2.5% WI, 2.008% NRI
Galveston Area Block 321	Black Elk Energy Offshore Operations LLC	0.5% ORRI
High Island Block 37	Hilcorp Energy Company	2.88% WI, 2.246% NRI

North Sumatra Basin-Langsa Field Located offshore Indonesia, the North Sumatra Basin-Langsa Field covers approximately 77 square kilometers and contains two oil fields the L Field and the H Field. Four wells have been completed in each field. All four wells in the L Field are currently shut-in. In the H Field, two of the wells have been plugged and abandoned, one is suspended and one (the H-4 Well) is currently producing. The wells are completed subsea in 325 feet of water and productive via flexible pipelines to a Floating Production Storage and Offloading barge. The H-4 Well is currently producing approximately 370 barrels of oil per day.

High Island Block 115 High Island Block 115 is located approximately 30 miles southeast of Bolivar Peninsula in an average water depth of approximately 38 feet. The block contains one active well, the B-1 ST2 Well. The B-1 ST2 Well is currently producing approximately 2 MMcf of gas per day.

Galveston Area Block 321 Galveston Area Block 321 is located approximately 32 miles southeast of Galveston in an average water depth of approximately 66 feet. The block contains one active well, the A-4 Well. The A-4 Well is currently producing approximately 2 MMcf of gas per day.

High Island Block 37 High Island Block 37 is located approximately 15 miles south of Sabine Pass in an average water depth of approximately 36 feet. The block contains no active wells.

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At December 31, 2011, there were no active drilling or development activities associated with our exploration and production assets.

Productive Wells and Acreage. The following table sets forth our ownership interest at December 31, 2011, in productive oil and natural wells in the areas indicated. Wells are classified as oil or natural gas according to their predominant production stream. Gross wells reflect the total number of producing wells in which we have an interest, and net wells are determined by multiplying gross wells by our average working or royalty interest. Productive wells consist of producing wells and wells capable of production.

	Oil		Natural Gas		Total	
	Gross	Net	Gross	Net	Gross	Net
Indonesia						
Working Interest	1.0	0.1			1.0	0.1
U.S. Gulf of Mexico						
Working Interest			2.0	0.1	2.0	0.1
Overriding Royalty Interest			1.0		1.0	
	1.0	0.1	3.0	0.1	4.0	0.2

The following table sets forth the approximate developed and undeveloped acreage that we held as leasehold interest at December 31, 2011. Undeveloped acreage includes leased acres on which wells have not been drilled or completed to a point that would permit the production of commercial quantities of oil or natural gas, regardless of whether or not such acreage contains proved reserves.

	Developed		Undeveloped		Total	
	Gross	Net	Gross	Net	Gross	Net
Indonesia	3,108	218	15,919	1,114	19,027	1,332
U.S. Gulf of Mexico	17,280	264			17,280	264
	20,388	482	15,919	1,114	36,307	1,596

Reserve Categories. Reserves are classified as either proved, probable or possible according to the degree of certainty associated with the estimates. This report contains no estimates of probable or possible reserves. Proved reserves as reported herein are further sub-categorized as either developed or undeveloped depending on their development and production status. The quantities of proved developed and undeveloped oil and gas reserves presented herein include only those amounts which we reasonably expect to recover in the future from known oil and gas reservoirs under existing economic and operating conditions. Therefore, proved developed and undeveloped reserves are limited to those quantities that are believed to be recoverable at prices and costs, and under regulatory practices and technology, existing at the time of the estimate. Accordingly, changes in oil and gas prices, operation and development costs, regulations, technology, future production and other factors, many of which are beyond our control, could significantly affect the estimates of proved developed and undeveloped reserves and the discounted present value of future net revenue attributable thereto.

Estimates of production and future net revenue cannot be expected to represent accurately the actual production or revenue that may be recognized with respect to oil and gas properties or the actual present market value of such properties. See Note (11), Supplemental Oil and Gas Information (Unaudited), in the Notes to Consolidated Financial Statements for further information concerning our proved developed and undeveloped reserves, changes in proved developed and undeveloped reserves, estimated future net revenue and costs incurred in our oil and gas activities and the discounted present value of estimated future net revenue from our proved developed and undeveloped reserves.

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Reserves Basis of Presentation. Our proved reserves and future net cash flows estimates for oil and natural gas were prepared by independent petroleum engineering consulting firms registered with the Society of Petroleum Engineers, as follows:

Indonesia
Stephen A. Lieberman, P.E.

U.S. Gulf of Mexico
Richard R. Lonquist, P.E.

President

President

American Energy Advisors, Inc.

Lonquist & Co., LLC

Mr. Lieberman has 37 years of experience in petroleum engineering, petroleum studies and evaluations. He attended Colorado School of Mines and Pennsylvania State University and earned a Bachelor of Science Degree in Petroleum and Natural Gas Engineering. He is a registered and active member of the Society of Petroleum Engineers.

Mr. Lonquist has more than 23 years of experience in petroleum engineering, underground storage engineering, mining engineering and financial consulting services for energy production, transmission and energy storage companies, banks, trusts and institutional investors. He earned a Bachelor of Science in Petroleum Engineering from Texas A&M University. He is a registered and active member of the Society of Petroleum Engineers and the Society of Petroleum Evaluation Engineers.

Evaluations done by Messrs. Lieberman and Lonquist were done in accordance with the generally accepted petroleum engineering and evaluation principles and the most recent definitions and guidelines established by the SEC. All reserve definitions contained herein are in accordance with the SEC's Rule 4-10(a)(1)-(32) of Regulation S-X.

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Estimated Proved Reserves and Future Net Cash Flows. The following table presents the estimates of proved developed and undeveloped reserves (as hereinafter defined) and the discounted present value of future net revenue or expenses from proved developed and undeveloped reserves after income taxes to our net interest in oil and gas properties as of December 31, 2011. The discounted present value of future net revenue or expenses is calculated using the SEC Method (defined below) and is not intended to represent the current market value of the oil and gas reserves we own.

Proved Natural Gas and Oil Reserves**as of December 31, 2011**

	Net Oil Reserves (Mbbls)	Net Gas Reserves (MMcf)	Discounted Present Value of Future Net Cash Inflows (Outflows) (1) (in thousands)
Proved Developed			
North Sumatra Basin-Langsa Field	31.6		\$ 1,339
High Island Block 115		13.0	1
Galveston Area Block 321			
High Island Block 37			(31)
Total Proved Developed Reserves	31.6	13.0	\$ 1,309
Proved Undeveloped			
North Sumatra Basin-Langsa Field	151.0		\$ 8,018
High Island Block 115			
Galveston Area Block 321			
High Island Block 37			
Total Proved Undeveloped Reserves	151.0		\$ 8,018

- (1) The estimated present value of future net cash outflows from our proved reserves has been determined by using domestic prices of \$96.04 per barrel of oil and \$4.18 per Mcf of gas and an international price of \$114.95 per barrel of oil, representing the 12-month average price for oil and natural gas, respectively, calculated as the unweighted arithmetic average of the first-day-of-the-month price for each month within the 12-month prior period to the end of the reporting period and discounted at a 10% annual rate in accordance with requirements for reporting oil and gas reserves pursuant to regulations promulgated by the SEC (the SEC Method).

We had total estimated proved undeveloped reserves of 175.3 Mbbls and 104.0 Mbbls as of December 31, 2011 and 2010, respectively. During 2011, we did not convert any proved undeveloped reserves to proved developed reserves. At December 31, 2011, no material amounts of proved undeveloped reserves have remained undeveloped for five years or more after they were initially disclosed as proved undeveloped reserves.

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Internal Controls over Reserve Estimates. We engaged independent petroleum engineering consulting firms to prepare our final reserve estimates and have relied on their expertise to ensure that our reserve estimates were prepared in compliance with SEC guidelines and with generally accepted petroleum engineering principles. The technical persons primarily responsible for the preparation of the reserve reports have been identified herein. We provided the independent petroleum engineering consulting firms with estimate preparation material such as property interests, production, current operation costs, current production prices and other information. This information was reviewed by our Principal Executive Officer and Principal Financial Officer to ensure accuracy and completeness of the data prior to submission to the petroleum engineering consulting firms.

Capital Expenditures for Proved Reserves. The following table presents information regarding the costs we expect to incur in activities associated with our proved reserves. These expenditures represent costs associated with the plugging and abandonment of wells. The information regarding proved reserves summarized in the preceding table assumes the following estimated undiscounted capital expenditures in the years indicated (amounts in thousands).

Estimated Undiscounted Capital Expenditures**Associated with Plugging and Abandonment of Wells**

	\$0000	\$0000	\$0000	\$0000	\$0000
	2012	2013	2014	2015	2016
North Sumatra Basin-Langsa Field					
High Island Block 115		\$ 39			
Galveston Area Block 321					
High Island Block 37	\$ 68				
High Island A-7	\$ 135				

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Production, Price and Cost Data. The following table presents information regarding production volumes and revenue, average sales prices and costs (after deduction of royalties and interests of others) with respect to crude oil, condensate and natural gas attributable to our interests for each of the periods indicated.

Net Production, Price and Cost Data

	Years Ended December 31,					
	2011		2010		2009	
	Indonesia	U.S. Gulf of Mexico	Indonesia	U.S. Gulf of Mexico	Indonesia	U.S. Gulf of Mexico
Crude Oil and Condensate:						
Production (Bbls)	10,254	272	8,154	250		250
Revenue	\$ 1,222,378	\$ 25,991	\$ 720,348	\$ 20,377	\$	\$ 17,401
Average production per day (Bbls) (*)	28.1	0.7	22.3	0.7		0.7
Average sales price per Bbl	\$ 119.21	\$ 95.56	\$ 88.34	\$ 81.51	\$	\$ 69.60
Natural Gas:						
Production (Mcf)		25,454		31,654		33,630
Revenue	\$	\$ 94,349	\$	\$ 121,960	\$	\$ 108,576
Average production per day (Mcf) (*)		69.7		86.7		92.1
Average sales price per Mcf	\$	\$ 3.71	\$	\$ 3.85	\$	\$ 3.23
Production Costs (**):						
Per Mcfe:	\$ 17.85	\$ 2.80	\$ 12.29	\$ 2.19	\$	\$ 2.71

(*) Average production is based on a 365 day year.

(**) Production costs, exclusive of work-over costs, are costs incurred to operate and maintain wells and equipment and to pay production taxes.

Drilling, Exploration and Development Activity. During 2011, there were no wells drilled or any other exploratory or development activities conducted.

Other Assets

We own a non-hazardous Class I salt water disposal well located near the town of Mermentau, Jefferson Davis Parish, Louisiana. The well is not currently operational.

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Revenue from customers exceeding 10% of our total revenue for 2011 and 2010 were as follows:

	Natural Gas and Oil Sales	Pipeline Operations	Customer Total	% of Total Revenue
<u>Year Ended December 31, 2011:</u>				
Blue Sky Langsa, Ltd.	\$ 1,222,378	\$	\$ 1,222,378	54%
<u>Year Ended December 31, 2010:</u>				
Blue Sky Langsa, Ltd.	\$ 720,348	\$	\$ 720,348	26%
W&T Offshore	\$	\$ 557,419	\$ 557,419	20%
Black Elk Energy Offshore Operations, LLC	\$ 48,194	\$ 296,921	\$ 345,115	12%

Markets & Competition

Petroleum industry operations and profitability are influenced by many factors. Prices for crude oil, natural gas, petroleum products and petrochemicals are generally determined by supply and demand. Demand for crude oil and its products and for natural gas is largely driven by the conditions of local, national and global economies, although weather patterns and taxation relative to other energy sources also play a significant part. Laws and governmental policies, particularly in the areas of taxation, energy and the environment affect where and how companies conduct their operations and formulate their products and, in some cases, limit their profits directly.

In view of the many uncertainties that affect petroleum industry operations, it is impossible to accurately predict the price and marketability of our oil and natural gas production or the rates charged for our transportation services. Currently, our oil production is sold at market prices at the time of lifting and our natural gas production is sold at market prices at the time of transmission to a major intrastate pipeline.

Intellectual Property

We rely on intellectual property laws to protect our brand, as well as those of our subsidiaries. Blue Dolphin is a registered trademark in the U.S. in name and logo form. Petroport is a registered trademark in the U.S. in name form. In addition, www.blue-dolphin.com is a registered domain name. Previously held patents in Belgium, Denmark, France, Germany, Great Britain, Greece, Israel, Italy, the Netherlands and Spain related to an offshore storage facility and terminal were abandoned in 2010.

Governmental Regulation

We are subject to numerous environmental, legal and regulatory requirements related to our domestic and foreign operations, which can have a significant impact upon our overall operations.

Domestic. In the United States, laws and regulations under which our operations are subject include, among others:

Federal Regulation of Natural Gas Transportation. Historically, the transportation and sales for resale of natural gas in interstate commerce have been regulated by the Natural Gas Act (NGA), the Natural Gas Policy Act (NGPA) and the rules and regulations promulgated by the Federal Energy Regulatory Commission (FERC). In the past, the federal government has regulated the prices at which gas could be sold. In 1989, Congress enacted the Natural Gas Wellhead Decontrol Act, which removed all remaining NGA and NGPA price and non-price controls affecting producer sales of gas, effective January 1, 1993. The Energy Policy Act of 2005 (the 2005 Energy Act) did not alter our non-FERC-jurisdictional status, but the 2005 Energy Act greatly expanded FERC 's enforcement authority, including enforcement against

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market manipulation in connection with FERC-jurisdictional transactions. Under the 2005 Energy Act, FERC has undertaken vigorous enforcement actions against a number of entities, including those not subject to direct FERC regulation, and, in an effort to increase transparency in natural gas markets, has taken steps to require reporting by interstate, major non-interstate and potentially certain intrastate pipelines. Additionally, energy pricing has attracted renewed political interest. Therefore Congress could reenact regulatory controls in the future. The rates, terms and conditions applicable to interstate transportation of gas by pipelines are regulated by FERC under the NGA, as well as under Section 311 of the NGPA. FERC has extended certain reporting requirements to otherwise non-jurisdictional intrastate pipelines and to major non-interstate natural gas pipelines, including non-jurisdictional gathering lines that deliver more than 50 million MMBtu per year, a cutoff that excludes us from this requirement. In February 2007, FERC issued a policy order acknowledging its lack of jurisdiction over offshore gathering, but stated that FERC would intervene in the event that interstate pipelines with affiliated offshore gathering lines engage in anti-competitive behavior, such as conditioning access to interstate pipeline service upon use of the affiliated gathering line.

All of our pipelines located offshore in federal waters are subject to the requirements of the Outer Continental Shelf Lands Act (OCSLA), which was administered by the Bureau of Ocean Energy Management, Regulation and Enforcement and, after October 1, 2011, its successors, the Bureau of Ocean Energy Management (the BOEM) and the Bureau of Safety and Environmental Enforcement (the BSEE). Together with the FERC, the BOEM and BSEE require that all pipelines operating on or across the shelf provide open-access, non-discriminatory service. There are currently no regulations implemented by the FERC under its OCSLA authority on gatherers and other entities outside the reach of its NGA jurisdiction. Therefore, we do not believe that any FERC, BOEM or BSEE action taken under OCSLA will affect us in a way that materially differs from the way it affects other natural gas producers, gatherers and marketers with which we compete.

Aside from the OCSLA requirements and federal safety and operational regulations, regulation of gas gathering activities is primarily a matter of state oversight. Regulation of gathering activities in Texas includes various transportation, safety, environmental and non-discriminatory purchase/transport requirements.

Federal Regulation of Oil Pipelines. Our operation of the Buccaneer Pipeline previously subjected us to a variety of regulations promulgated by FERC and imposed on all oil pipelines pursuant to federal law. The Buccaneer Pipeline was sold to Sunoco in August 2011 and the associated FERC tariffs were adopted by Sunoco per its adoption notice FERC no. 191.0.0 issued August 25, 2011.

Safety and Operational Regulations. Our operations are generally subject to safety and operational regulations administered by the BSEE, the Department of Transportation, the Coast Guard, FERC and/or various state agencies. The recently enacted Pipeline Safety, Regulatory Certainty and Job Creation Act of 2011 requires that the Secretary of Transportation develop several new regulatory programs to enhance pipeline safety over the coming years. In addition, the OCSLA authorizes regulations relating to safety and environmental protection applicable to lessees and permittees operating on the OCS. Specific design and operational standards may apply to OCS vessels, rigs, platforms and structures. Violations of lease conditions or regulations issued pursuant to the OCSLA can result in substantial civil and criminal penalties, as well as potential court injunctions curtailing operations and the cancellation of leases. Such enforcement liabilities can result from either governmental or private prosecution. Currently, we believe that we are in material compliance with the various safety and operational regulations that we are subject to. However, as safety and operational regulations are frequently changed, we are unable to predict the future effect changes in these regulations will have on our operations, if any.

Federal Oil and Gas Leases. Our U.S. Gulf of Mexico exploration and production operations are currently located on federal oil and gas leases in the OCS, which are administered by BOEM. Such leases are issued through competitive bidding, contain relatively standardized terms and require compliance with detailed BOEM regulations and orders pursuant to the OCSLA that are subject to interpretation and change by

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BOEM. For offshore operations, lessees must obtain BOEM approval for exploration plans and development and production plans prior to the commencement of such operations. In addition to permits required from other agencies, such as the U.S. Coast Guard, the Army Corps of Engineers and the Environmental Protection Agency (the EPA), lessees must obtain a permit from BOEM prior to the commencement of drilling. BOEM has promulgated regulations requiring offshore production facilities located on the OCS to meet stringent engineering and construction specifications. To cover the various obligations of lessees on the OCS, BOEM generally requires that lessees have substantial net worth or post bonds or other acceptable assurance that such obligations will be met. The cost of such bonds or other surety can be substantial, and there is no assurance that bonds or other surety can be obtained in all cases. We are currently in compliance with the bonding requirements of BOEM. Under some circumstances, BOEM may require any of our operations on federal leases to be suspended or terminated. Any such suspension or termination could materially adversely affect our financial condition and results of operations.

With respect to our operations that are conducted on offshore federal leases, liability may generally be imposed under OCSLA for clean-up costs and pollution damages resulting from such operations, generally excluding damages caused by acts of war or the negligence of third parties. Under certain circumstances, including but not limited to conditions deemed a threat or harm to the environment, BOEM may also require any of our operations on federal leases to be suspended or terminated in the affected area. Furthermore, BOEM generally requires that offshore facilities be dismantled and removed within one year following production cessation or lease expiration.

Environmental Regulation. Our activities with respect to: (i) exploration, development and production of oil and natural gas and (ii) operation and construction of pipelines, plants and other facilities for the transportation of oil and natural gas are subject to stringent environmental regulation by local, state and federal authorities, including the EPA. Such regulation has increased the cost of planning, designing, drilling, operating and, in some instances, abandoning wells and related equipment. Similarly, such regulation has also increased the cost of design, construction and operation of crude oil and natural gas pipelines and processing facilities. Although we believe that compliance with existing environmental regulations will not have a material adverse effect on our operations or earnings, there can be no assurance that significant costs and liabilities, including civil and criminal penalties, will not be incurred. Moreover, future developments, such as stricter environmental laws and regulations or claims for personal injury or property damage resulting from our operations, could result in substantial costs and liabilities. In the event significant changes in environmental requirements occur, we may be required to expend amounts that are material relative to our total capital structure.

The Comprehensive Environmental Response, Compensation and Liability Act (CERCLA) imposes liability, without regard to fault or the legality of the original conduct, on parties the statute defines as responsible for the release or threatened release of a hazardous substance into the environment. Responsible parties, which include the present owner or operator of a site where the release occurred, the owner or operator of the site at the time of disposal of the hazardous substance, and persons that disposed of or arranged for the disposal of a hazardous substance, are liable for response and remediation costs and for damages to natural resources. Petroleum and natural gas are excluded from the definition of hazardous substances; however, this exclusion does not apply to all materials used in our operations. State statutes impose similar liability. At this time, neither we nor any of our predecessors have been designated as a potentially responsible party under CERCLA or similar state statute.

The federal Resource Conservation and Recovery Act (RCRA) and its state counterparts regulate solid and hazardous wastes and impose civil and criminal penalties for improper handling and disposal of such wastes. EPA and various state agencies have promulgated regulations that limit the disposal options for such wastes. Certain wastes generated by our oil and gas operations are currently exempt from regulation as hazardous wastes, but in the future could be designated as hazardous wastes under RCRA or other applicable statutes and therefore may become subject to more rigorous and costly requirements.

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We currently own or lease, or have in the past owned or leased, various properties used for the exploration and production of oil and gas or used to store and maintain equipment regularly used in these operations. Although our past operating and disposal practices at these properties were standard for the industry at the time, hydrocarbons or other substances may have been disposed of or released on or under these properties or on or under other locations. In addition, many of these properties have been operated by third parties whose waste handling activities were not under our control. These properties and any waste disposed thereon may be subject to CERCLA, RCRA, and state laws which could require us to remove or remediate wastes and other contamination or to perform remedial plugging operations to prevent future contamination.

The Oil Pollution Act of 1990 (OPA) and regulations promulgated thereunder include a variety of requirements related to the prevention of oil spills and impose liability for damages resulting from such spills. OPA imposes liability on owners and operators of onshore and offshore facilities and pipelines for removal costs and certain public and private damages arising from a spill. OPA establishes a liability limit for onshore facilities of \$350 million and offshore facilities of \$75 million plus all clean-up costs. OPA establishes lesser liability limits for vessels depending upon their size. A party cannot take advantage of the liability limits if the spill is caused by gross negligence or willful misconduct or resulted from a violation of federal safety, construction or operating regulations. If a party fails to report a spill or cooperate in the clean-up, liability limits do not apply. OPA imposes ongoing requirements on responsible parties, including proof of financial responsibility for potential spills. The amount of financial responsibility required depends upon a variety of factors, including the facility or vessel type, size, storage capacity, oil throughput, proximity to sensitive areas, type of oil handled, discharge history, worst-case spill potential and other considerations. We believe we have established adequate financial responsibility. While our financial responsibility requirements under OPA may be amended to impose additional costs, we do not expect the impact of such a change to be any more burdensome on us than on others similarly situated.

The Clean Air Act and state air quality laws and regulations contain provisions that impose pollution control requirements on emissions to the air and require permits for construction and operation of certain emissions sources, including sources located offshore. We may be required to incur capital expenditures for air pollution control equipment in connection with maintaining or obtaining construction and operating permits and approvals addressing emission-related issues, although we do not expect to be materially adversely affected by such expenditures.

The Clean Water Act (CWA) regulates the discharge of pollutants to waters of the United States and imposes permit requirements on such discharges, including discharges to wetlands. Federal regulations under the CWA and OPA require certain owners or operators of facilities that store or otherwise handle oil, to prepare and implement spill prevention, control and countermeasure plans and facility response plans relating to the possible discharge of oil into surface waters. With respect to certain of our operations, we are required to prepare and comply with such plans and to obtain and comply with permits. The CWA also prohibits spills of oil and hazardous substances to waters of the United States in excess of levels set by regulations and imposes liability in the event of a spill. State laws further provide varying civil and criminal penalties and liabilities for the spills to both surface and ground waters. We believe we are in substantial compliance with the requirements of the CWA, OPA and state laws, and that any non-compliance would not have a material adverse effect on us.

Various federal and state programs regulate the conservation and development of coastal resources. The federal Coastal Zone Management Act was passed to preserve and, where possible, restore the natural resources of the coastal zone of the United States and to provide for federal grants for state management programs that regulate land use, water use and coastal development. Under the Louisiana Coastal Zone Management Program, coastal use permits are required for certain activities, even if the activity only partially infringes upon the coastal zone. Among other things, projects involving use of state lands and water bottoms, dredge or fill activities that intersect with more than one body of water, mineral activities, including the exploration and production of oil and gas, and pipelines for the gathering, transportation or

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transmission of oil, gas and other minerals require such permits. General permits, which entail a reduced administrative burden, are available for a number of routine oil and gas activities. The Texas Coastal Coordination Act (TCCA) establishes the Texas Coastal Management Program that applies in the nineteen Texas counties that border the U.S. Gulf of Mexico and its tidal bays. The TCCA provides for the review of state and federal agency rules and agency actions for consistency with the goals and policies of the Coastal Management Plan. These coastal programs may affect agency permitting of our facilities.

Legislation and Rulemaking. In October 1996, the U.S. Congress enacted the Coast Guard Authorization Act of 1996 (P.L. 104-324), which amended the OPA to establish requirements for evidence of financial responsibility for certain offshore facilities. The evidence of financial responsibility amount required is \$35 million for certain types of offshore facilities located seaward of the seaward boundary of a state, including properties used for oil transportation. We currently maintain the statutory \$35 million coverage.

Federal and state legislation and regulations have been proposed that, if enacted or promulgated, could significantly affect operations in the oil and gas industry. It is not possible to predict which of the proposals, if any, will be adopted and what effect, if any, they would have on our operations. However, changes in various federal, state and local laws and regulations covering the discharge of materials into the environment, occupational health and safety issues or otherwise relating to the protection of public health and the environment, may affect our operations and costs to do business. Historically, the trend in such laws and regulations has been to place more restrictions and limitations on activities that may impact the general or work environment, such as emissions of pollutants, generation and disposal of wastes and use and handling of chemical substances, the cost of compliance of which has continued to increase. It is not possible to predict which of the proposed federal, state and local laws and regulations, if any, will be adopted and the impact such changes may have on our operations and capital structure. We will adopt measures that maintain our compliance.

Foreign. In Indonesia, our operations are subject to the government acts, laws and regulations of the Republic of Indonesia, as well as to any international treaties or conventions to which the Republic of Indonesia is a signatory.

Employees

At December 31, 2011, we had five (5) full-time employees and regularly used the services of one (1) consultant. Our employees, along with the expertise provided by our engineering consultant, manage our ongoing administrative, business development and marketing operations. From time to time, we use third parties to assist with major maintenance, engineering and construction projects and activities.

Environmental

A description of our environmental activities is included in Part II, Item 8, Financial Statements and Supplementary Data.

Available Information

We make available, free of charge on or through our website (<http://www.blue-dolphin.com>), our annual, quarterly and current reports, and any amendments to those reports, as soon as practical after these reports are filed with the SEC. The public may read and copy any materials we file with the SEC at the SEC's Public Reference Room at 100 F Street, Northeast, Washington, D.C. 20549, on official business days during the hours of 10:00 a.m. to 3:00 p.m. The public may obtain information on the operation of the Public Reference Room by calling the SEC at (800) SEC-0330. The SEC maintains an Internet site (<http://www.sec.gov>) that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC.

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Information about each of our directors, as well as each of the Board's standing committee charters, our corporate governance guidelines and our code of business conduct are also available, free of charge, through our website. Information contained on our website is not part of this report.

Glossary of Certain Oil and Gas Terms

The following are abbreviations and definitions of certain terms commonly used in the oil and gas industry.

Back-in After Payout Interest. A contractual right of a non-participating partner to participate in a well or wells after the wells have produced enough for the participating partners to recover their capital costs of drilling, completing and operating the wells.

Bbl. One stock tank barrel, or 42 U.S. gallons of liquid volume, used in reference to oil or other liquid hydrocarbons.

Bcf. One billion cubic feet of gas.

Btu or British Thermal Unit. The quantity of heat required to raise the temperature of one pound of water by one degree Fahrenheit.

Condensate. Hydrocarbons which are in the gaseous state under reservoir conditions and which become liquid when temperature or pressure is reduced; a mixture of pentanes and higher hydrocarbons.

Development Well. A well drilled within the proved area of a gas or oil reservoir to the depth of a stratigraphic horizon known to be productive.

Exploratory Well. A well drilled to find and produce gas or oil in an unproved area, to find a new reservoir in a field previously found to be productive of gas or oil in another reservoir or to extend a known reservoir.

Field. An area consisting of a single reservoir or multiple reservoirs all grouped on or related to the same individual geological structural feature and/or stratigraphic condition.

Leasehold Interest. The interest of a lessee under an oil and gas lease.

Mbbls. One thousand barrels of oil or other liquid hydrocarbons.

Mcf. One thousand cubic feet of gas.

Mcfe. One thousand cubic feet equivalent, determined using the ratio of six Mcf of gas to one barrel of oil, condensate or gas liquids.

MMbtu. One million British Thermal Units.

MMcf. One million cubic feet of gas.

MMcfe. One million cubic feet equivalent, determined using the ratio of six Mcf of gas to one Bbl of oil, condensate or gas liquids.

Net Revenue Interest. The percentage of production to which the owner of a working interest is entitled.

Non-operating Working Interest. A working interest, or a fraction of a working interest, in a lease where the owner is not the operator of the lease.

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Overriding Royalty Interest. An interest in oil and gas produced at the surface, free of the expense of production that is in addition to the usual royalty interest reserved to the lessor in an oil and gas lease.

Prospect. A specific geographic area which, based on supporting geological, geophysical or other data and also preliminary economic analysis using reasonably anticipated prices and costs, is deemed to have potential for the discovery of oil, gas or both.

Proved Developed Reserves. Reserves that can be expected to be recovered through existing wells with existing equipment and operating methods. Proved developed reserves are further categorized into two sub-categories – proved developed producing reserves and proved developed non-producing reserves.

Proved Developed Producing. Reserves sub-categorized as producing are expected to be recovered from completion intervals which are open and producing at the time of the estimate.

Proved Developed Non-producing. Reserves sub-categorized as non-producing, which include shut-in and behind pipe reserves. Shut-in reserves are expected to be recovered from: (i) completion intervals which are open at the time of the estimate but which have not started producing, (ii) wells which were shut-in awaiting pipeline connections or as a result of a market interruption or (iii) wells not capable of producing for mechanical reasons.

Proved Reserves. The estimated quantities of oil, gas and condensate that geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions. Proved reserves are further categorized into two sub-categories – proved developed and proved undeveloped depending on their development and production status.

Proved Undeveloped Reserves. Reserves that are expected to be recovered from new wells or from existing wells where a relatively significant expenditure is required for recompletion.

Reversionary Interest. A form of ownership interest in property that reverts back to the transferor after expiration of an intervening income interest or the occurrence of another triggering event.

Royalty Interest. An interest in a gas and oil property entitling the owner to a share of gas and oil production free of any of the operational costs associated with the production.

Undivided Interest. A form of ownership interest in which more than one person concurrently owns an interest in the same oil and gas lease or pipeline.

Working Interest. The operating interest that gives the owner the right to drill, produce and conduct operating activities on the property and receive a share of production after the corresponding percentage of operational costs and royalties are paid.

ITEM 1A. RISK FACTORS

There are numerous factors that affect our business and operating results, many of which are beyond our control. The following is a description of significant factors that might cause our future operating results to differ materially from those currently expected. The risks described below are not the only risks we face. Additional risks and uncertainties not specified herein, not currently known to us or currently deemed to be immaterial also may materially adversely affect our business, financial position, operating results and/or cash flows.

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Risks Related to our Business

The success of our acquisition of LE will depend on our ability to realize the anticipated benefits from integrating LE's business into our operations.

We may fail to realize the anticipated benefits from this integration on a timely basis, or at all, for a variety of reasons, including the following:

difficulties expanding in new markets or geographies where we have no or limited direct prior experience;

failure to identify or assess the magnitude of certain liabilities we assumed in the acquisition, which could result in unexpected litigation or regulatory exposure, unfavorable accounting treatment, unexpected increases in taxes due, a loss of anticipated tax benefits or other adverse effects on our business, operating results or financial condition;

difficulties or delays in incorporating acquired technologies or integrating overall operations and business systems while maintaining uniform standards, controls, processes and policies;

failure to successfully manage relationships with our combined supplier and customer base; and

difficulties in modifying LE's existing accounting and internal control systems to comply with Section 404 of the Sarbanes-Oxley Act of 2002, to which LE is not currently subject, which could adversely impact the effectiveness of internal control over financial reporting for the combined company.

Refining margins are volatile, and a reduction in anticipated refining margins will adversely affect the amount of cash we will have available for working capital.

Historically, refining margins have been volatile, and they are likely to continue to be volatile in the future. Our financial results are primarily affected by the relationship, or margin, between our specialty products prices and the prices for crude oil. The cost to acquire crude oil and the price at which we can ultimately sell our refined products depend upon numerous factors beyond our control.

The prices at which we sell specialty products are strongly influenced by the commodity price of crude oil. If crude oil prices increase, our specialty products segment margins will fall unless we are able to pass along these price increases to our wholesale customers. Increases in selling prices for specialty products typically lag the rising cost of crude oil and may be difficult to implement when crude oil costs increase dramatically over a short period of time.

The sale of refined products to the wholesale market is an important part of our business going forward, and if we fail to grow and maintain our market share or gain market acceptance of our refined products, our operating results could suffer.

Selling refined products to the wholesale market is an important part of our business, and as our refined products revenue increases as a portion of our overall revenue, our success in the wholesale market becomes increasingly important to our operating results. Our success in the wholesale market depends in large part on our ability to grow and maintain our image and reputation as an independent operator and to expand into and gain market acceptance of our refined products. Adverse perceptions of product quality, whether or not justified, or allegations of product quality issues, even if false or unfounded, could tarnish our reputation and cause our wholesale customers to choose refined products offered by our competitors.

We are dependent on third-party operators for the transportation of crude oil into and refined products out of our Nixon Facility, and if these third-party operators become unavailable to us, our ability to process crude oil and sell refined products to wholesale markets could be materially and adversely affected.

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We rely on trucks for the receipt of crude oil into and the sale of refined products out of our Nixon Facility. Since we do not own or operate any of these trucks, their continuing operation is not within our control. If any of the third-party trucking companies that we use, or the trucking industry in general, become unavailable to transport crude oil or our refined products because of acts of God, accidents, government regulation, terrorism or other events, our revenue and net income would be materially and adversely affected.

Potential downtime for maintenance at the Nixon Facility could reduce our revenue and cash available for payments of our obligations.

Although currently operating at anticipated levels, the Nixon Facility is still in a recommissioning phase and may require additional unscheduled downtime for unanticipated maintenance or repairs. Any scheduled or unscheduled maintenance reduces our revenues and increases our operating expenses during the period of time that our processing unit is not operating and could reduce our ability to meet our payment obligations.

Our operations, including our operation of the Nixon Facility, subject us to the inherent risk of incurring significant environmental costs and liabilities.

There is inherent risk of incurring significant environmental costs and liabilities in the operation of the Nixon Facility due to our handling of petroleum hydrocarbons and wastes, because of air emissions and water discharges related to our operations, and as a result of historical operations and waste disposal practices of prior owners of our facilities. We currently own or operate properties that for many years have been used for industrial activities, including refining or terminal storage operation. Private parties, including the owners of properties adjacent to our operations and facilities where our petroleum hydrocarbons or wastes are taken for reclamation or disposal, may also have the right to pursue legal actions to enforce compliance as well as to seek damages for non-compliance with environmental laws and regulations or for personal injury or property damage. We may not be able to recover some or any of these costs from insurance or other sources of indemnity. To the extent that the costs associated with meeting any or all of these requirements are substantial and not adequately provided for, there could be a material adverse effect on our business, financial condition, and results of operations.

Our relationship with LEH and our related party transactions with LEH and its affiliates may cause conflicts of interest that may adversely affect us.

LEH owns approximately eighty percent (80%) of our issued and outstanding Common Stock. Jonathan P. Carroll, our Chief Executive Officer, President, Assistant Treasurer and Secretary, and Tommy L. Byrd, our interim Chief Financial Officer, Treasurer and Assistant Secretary, are also a member and Chief Financial Officer, respectively, of LEH and as a result may, under certain circumstances, have interests that differ from or conflict with our interests. Further, pursuant to the Management Agreement, LEH manages and operates the Nixon Facility and Blue Dolphin's other operations. As a result of their relationship with LEH, Messrs. Carroll and Byrd may experience conflicts of interest in the execution of their duties on behalf of Blue Dolphin including with respect to the Management Agreement.

LEH has no fiduciary duty to make decisions in our best interest. LEH is entitled to vote the Common Stock it owns in accordance with its interests, which may be contrary to our interests and those of other stockholders. LEH has interests that differ from the interests of our stockholders and, as a result, there is a risk that important business decisions will not be made in the best interest of our stockholders. LEH and its other affiliates are not limited in their ability to compete with us and are not obligated to offer us business opportunities. We believe that the transactions and agreements that we have entered into with LEH and its affiliates are on terms that are at least as favorable as could reasonably have been obtained at such time from third parties. However, these relationships could create, or appear to create, potential conflicts of interest when our Board is faced with decisions that could have different implications for us and LEH or its affiliates. The appearance of conflicts, even if such conflicts do not materialize, might

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adversely affect the public's perception of us, as well as our relationship with other companies and our ability to enter into new relationships in the future, which may have a material adverse effect on our ability to do business.

LEH holds a significant interest in us.

LEH owns approximately eighty percent (80%) of our issued and outstanding Common Stock. Through its ownership of such a large amount of Common Stock, LEH has significant influence over matters such as the election of our Board, control over our business, policies and affairs and other matters submitted to our stockholders.

Declines in throughput volumes and production rates from our leasehold properties in the U.S. Gulf of Mexico are expected to continue.

In recent years, throughput volumes on our pipelines and production rates from our leasehold properties in the U.S. Gulf of Mexico have continued to decline as a result of decreased activity in the U.S. Gulf of Mexico and depleting reserves. Following the April 2010 Deepwater Horizon explosion and oil spill, regulators have continued to move slowly in issuing new drilling permits in the U.S. Gulf of Mexico. This has negatively impacted our ability to attract new producers/shippers to our pipelines and make additional investments in new oil and gas properties. Although our U.S. Gulf of Mexico oil and gas properties may continue to operate over the next twelve to eighteen months, we expect the operating costs to exceed gross revenues based on current reserves and net cash flow estimates making these properties uneconomic.

During the past year, we have been primarily dependent on revenue from one key customer.

As a result of decreased revenue from pipeline operations and oil and gas sales related to our U.S. Gulf of Mexico leasehold interests, revenue from the North Sumatra Basin-Langsa Field accounted for approximately 54% of our total revenue in 2011 compared to approximately 26% in 2010. Unless we are able to offset this revenue with revenue from the sale of refined products, transportation throughput, interests in other oil and gas properties or other revenue generating assets at an acceptable cost, our financial condition could be materially adversely affected if production from the North Sumatra Basin-Langsa Field declines sharply or ceases.

If we are not able to generate sufficient funds from operations or obtain financing from other sources, we may not be able to continue our operations.

In recent years we have used a portion of our cash reserves to fund working capital requirements that were not funded from our operations. Continued pipeline underutilization, low commodity prices, production problems, reserve declines, unfavorable drilling results and other factors beyond our control could further reduce funds from our operations. Currently, we project that our current cash reserves will be sufficient to meet our obligations. If we are unable to realize the benefits of our acquisition of LE or obtain additional funds, we may have to seek debt and/or equity financing to meet our working capital requirements. Our history of losses may affect our ability to raise additional capital and increase the cost and terms of obtaining such financing. In the event we are not able to raise additional capital, we may be forced to sell our assets or discontinue our operations.

A substantial and extended decline in the prices of oil or gas would have a material adverse effect on our operations.

Our revenue, profitability, operating cash flow and potential for growth are largely dependent on prevailing oil and natural gas prices. Prices for oil and natural gas are subject to large fluctuations in response to relatively minor changes in the supply and demand for oil and natural gas, uncertainties within the market and a variety of other factors beyond our control. These factors include:

