

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10QSB/A

BLUE DOLPHIN ENERGY CO  
Form 10QSB/A  
November 14, 2005

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-QSB/A  
AMENDMENT NO. 2

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended: MARCH 31, 2005

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 For the transition period from .....to .....

Commission File Number: 0-15905

BLUE DOLPHIN ENERGY COMPANY  
(Exact name of small business issuer as specified in its charter)

DELAWARE  
(State or other jurisdiction of  
incorporation or organization)

73-1268729  
(I.R.S. Employer  
Identification No.)

801 TRAVIS, SUITE 2100, HOUSTON, TEXAS 77002  
(Address of principal executive offices)

(713) 227-7660  
(Issuer's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report.)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

State the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date.

As of November 10, 2005, there were 9,939,302 shares of the registrant's common stock, par value \$.01 per share, outstanding.

Transitional Small Business Disclosure Format (Check one): Yes  No

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This Amendment No. 2 on Form 10-QSB/A amends the Quarterly Report on Form 10-QSB for the quarter ended March 31, 2005, as amended by Amendment No. 1 on Form 10-QSB/A filed with the Securities and Exchange Commission (the "SEC") on July 6, 2005. As previously disclosed in the Current Report on Form 8-K filed with the SEC on October 31, 2005, our management, in consultation with members of our Audit Committee and UHY Mann Frankfort Stein & Lipp CPAs, LLP, our independent registered public accounting firm, concluded that our previously issued financial statements for the quarterly period ended March 31, 2005 should no longer be relied upon because of errors in the financial statements. The underlying errors relate to our treatment of the "cashless" exercise of compensatory stock options by certain of our directors and employees. This amendment is being filed solely to reflect the restatement of certain financial information for the quarter ended March 31, 2005 to address the errors.

The non-cash compensation expense recognized in this amendment increases the net loss for the quarter ended March 31, 2005 by approximately \$533,000, or \$.07 per common share. For a more detailed description, see Note 6. "Stock Based Compensation" of the Notes to Condensed Interim Consolidated Financial Statements.

This Form 10-QSB/A amends and restates "Item 1. Financial Statements," "Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations," and "Item 3. Controls and Procedures" of Part I of the Form 10-QSB, as amended, for the quarter ended March 31, 2005 to reflect the restatement of certain financial information. Except for Items 1, 2 and 3 of Part I, pursuant to Rule 12b-15 of the Securities Exchange Act of 1934, and new certifications from the Chief Executive Officer and Principal Accounting and Financial Officer, no other information included in the original Quarterly Report on Form 10-QSB, as amended, is amended by this Form 10-QSB/A. This report continues to be presented as of the date of the original Quarterly Report on Form 10-QSB, as amended, and we have not updated the disclosure in this report to a later date.

### PART I. FINANCIAL INFORMATION

#### ITEM 1. FINANCIAL STATEMENTS

The condensed consolidated financial statements of Blue Dolphin Energy Company and subsidiaries (referred to herein, with its predecessors and subsidiaries, as "Blue Dolphin", "we," "us" and "our") included herein have been prepared by us, without audit, pursuant to the rules and regulations of the SEC and, in the opinion of management, reflect all adjustments necessary to present a fair statement of operations, financial position and cash flows. We follow the full-cost method of accounting for oil and gas properties, wherein costs incurred in the acquisition, exploration and development of oil and gas reserves are capitalized. We believe that the disclosures are adequate and the information presented is not misleading, although certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations.

Our accompanying condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-KSB for the year ended December 31, 2004.

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MARCH 31, 2005

	RESTATED
	-----
ASSETS	
Current assets:	
Cash and cash equivalents	\$ 1,262,071
Accounts receivable	582,936
Prepaid expenses and other assets	262,747
	-----
TOTAL CURRENT ASSETS	2,107,754
Property and Equipment, at cost:	
Oil and Gas properties, including \$103,366 of unproved leasehold cost (full-cost method)	443,009
Pipelines	4,547,362
Onshore separation and handling facilities	1,664,128
Land	860,275
Other property and equipment	257,020
	-----
	7,771,794
Less: Accumulated depletion, depreciation, amortization and impairment	2,604,761
	-----
	5,167,033
Other Assets	11,359
	-----
TOTAL ASSETS	\$ 7,286,146
	=====
LIABILITIES AND STOCKHOLDERS' EQUITY	
Current Liabilities:	
Accounts payable	\$ 930,256
Notes payable	300,000
Current portion of long-term debt	130,000
Accrued expenses and other liabilities	50,744
	-----
TOTAL CURRENT LIABILITIES	1,411,000
Long-term debt	1,040,000
Interest payable	21,403
Asset retirement obligations	1,646,134
Common Stock, (\$.01 par value, 25,000,000 shares authorized, 7,736,199 shares issued and outstanding)	77,362
Additional Paid-in Capital	27,653,881
Accumulated Deficit	(24,563,634)
	-----
	3,167,609
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 7,286,146
	=====

See accompanying notes to the condensed consolidated financial statements.

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BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS - UNAUDITED

	Three Months Ended March 31,	
	RESTATED	
	2005	2004
	-----	-----
Revenue from operations:		
Pipeline operations	\$ 321,615	\$ 204,039
Oil and gas sales	37,415	154,892
	-----	-----
	359,030	358,931
	-----	-----
Cost of operations:		
Pipeline operating expenses	287,860	243,251
Lease operating expenses	16,634	31,839
Depletion, depreciation and amortization	85,829	134,782
General and administrative	960,740	496,014
Accretion expense	24,405	23,356
	-----	-----
	1,375,468	929,242
	-----	-----
LOSS FROM OPERATIONS	(1,016,438)	(570,311)
Other Income (expense):		
Interest and other expense	(39,447)	(11,702)
Interest and other income	325,448	85,709
Equity in loss of affiliate	-	(23,302)
	-----	-----
LOSS BEFORE INCOME TAXES	(730,437)	(519,606)
Income taxes	-	-
	-----	-----
Net loss	\$ (730,437)	\$ (519,606)
	=====	=====
Loss per common share		
- basic and diluted	\$ (0.10)	\$ (0.08)
	=====	=====
Weighted average number of common shares outstanding		
- basic and diluted	7,669,083	6,663,990
	=====	=====

See accompanying notes to the condensed consolidated financial statements.

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## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS - UNAUDITED

	Three Months Ended March 31, RESTATED	
	2005	2004
<b>OPERATING ACTIVITIES</b>		
Net loss	\$ (730,437)	\$ (519,606)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depletion, depreciation and amortization	85,829	134,782
Amortization of debt issue costs	11,439	-
Gain on sale of oil and gas property	(140,409)	-
Accretion of asset retirement obligations	24,405	23,356
Equity in loss of affiliate	-	23,302
Common stock issued for services	-	83,000
Gain on debt restructuring	(132,368)	-
Compensation expense for exercise of stock options	533,445	-
Changes in operating assets and liabilities:		
Accounts receivable	(266,572)	(124,838)
Prepaid expenses and other assets	(80,518)	4,925
Trade accounts payable and accrued expenses	217,635	(578,445)
	(477,551)	(953,524)
<b>NET CASH USED IN OPERATING ACTIVITIES</b>	<b>(477,551)</b>	<b>(953,524)</b>
<b>INVESTING ACTIVITIES</b>		
Property, equipment and other assets	(3,284)	(5,767)
Proceeds from sale of assets	214,632	-
Development costs - New Avoca	-	(16,500)
	211,348	(22,267)
<b>NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES</b>	<b>211,348</b>	<b>(22,267)</b>
<b>FINANCING ACTIVITIES</b>		
Payments on Borrowings	(30,000)	-
Financing costs	(2,275)	-
	(32,275)	-
<b>NET CASH USED IN FINANCING ACTIVITIES</b>	<b>(32,275)</b>	<b>-</b>
<b>DECREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(298,478)</b>	<b>(975,791)</b>
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	1,560,549	2,702,892
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 1,262,071	\$ 1,727,101

See accompanying notes to the condensed consolidated financial statements

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UNAUDITED  
MARCH 31, 2005

## 1. LIQUIDITY

At March 31, 2005, our working capital was approximately \$.6 million. Because of our recurring losses and negative cash flows from operations, our independent registered public accounting firm included a "going concern" explanatory paragraph in their report on our audited financial statements as of December 31, 2004 and for the two-year period ended December 31, 2004. There was substantial doubt about our ability to continue as a going concern. As of December 31, 2004, in order to satisfy our debt and working capital and capital expenditure requirements for the year ending December 31, 2005, we believed that we would need to raise approximately \$500,000.

During April 2005, we arranged an extension of the maturity dates from September 8, 2005 to June 30, 2006 and deferred the payment of all interest on the \$450,000 promissory notes until maturity. Even though we continue to incur losses from operations due to the poor performance of our assets, we currently believe that we have sufficient resources in order to satisfy our working capital and capital expenditure requirements for the twelve months ending March 31, 2006. However, we must achieve positive operating results or acquire assets with positive cash flows in order to satisfy our cash requirements thereafter.

The net cash provided by or used in operating, investing and financing activities is summarized below:

	Three Months Ended March 31, (amounts in thousands)	
	-----	
	RESTATED	
	2005	2004
	-----	-----
Net cash provided by (used in):		
Operating activities	\$ (477)	\$ (954)
Investing activities	211	(22)
Financing activities	(32)	-
	-----	-----
Net decrease in cash	\$ (298)	\$ (976)
	=====	=====

## 2. RELATED PARTY TRANSACTIONS

On September 8, 2004, we sold the common stock of our wholly owned subsidiary American Resources Offshore, Inc. ("ARO") to Ivar Siem on behalf of those stockholders who hold a number of shares of our common stock above a threshold determined by Mr. Siem, which included 30 of our largest shareholders on a proportionate basis. Messrs. Siem and Kaffie, Michael J. Jacobson, our President, and G. Brian Lloyd, our former Vice President and Treasurer received stock representing approximately 12%, 14%, 3% and 3%, respectively, of ARO. ARO had no revenue and no assets, except for federal net operating loss carryforwards. The consideration paid to us consisted of \$1,000 cash, the assumption of the transaction

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## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS UNAUDITED - CONTINUED MARCH 31, 2005

costs, including incremental costs associated with the reporting and disclosure of this transaction incurred by us in our filings with the SEC and any other required filings or announcements, and the assumption of any and all liabilities of ARO.

### 3. CONTINGENCIES

We are involved in various claims and legal actions arising in the ordinary course of business. In our opinion, the ultimate disposition of these matters will not have a material effect on our financial position, results of operations or cash flows.

### 4. EARNINGS PER SHARE

We apply the provisions of Statement of Financial Accounting Standards No. 128 ("SFAS 128"), "Earnings per Share". SFAS 128 requires the presentation of basic earnings per share ("EPS") which excludes dilution and is computed by dividing net income (loss) available to common stockholders by the weighted-average number of shares of common stock outstanding for the period. SFAS 128 requires dual presentation of basic EPS and diluted EPS on the face of the income statement and requires a reconciliation of the numerators and denominators of basic EPS and diluted EPS.

Employee stock options and stock warrants at March 31, 2005 and 2004 were not included in the computation of diluted earnings per share because the effect of their assumed exercise and conversion would have an antidilutive effect on the computation of diluted loss per share.

	RESTATED Net Loss -----	Weighted- Average Number of Common Shares Outstanding and Potential Dilutive Common Shares -----	RESTATED Per Share Amount -----
Three months ended March 31, 2005			
Basic and diluted loss per share	\$ (730,437) =====	7,669,083 =====	\$ (0.10) =====
Three months ended March 31, 2004			
Basic and diluted loss per share	\$ (519,606) =====	6,663,990 =====	\$ (0.08) =====

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### 5. BUSINESS SEGMENT INFORMATION

Our income producing operations are conducted in two principal business segments: pipeline operations and oil and gas exploration and production. There were no intersegment revenues during the periods presented. Information concerning these segments for the three months ended March 31, 2005 and 2004, and at March 31, 2005 are as follows:

	Revenues	RESTATED Operating Loss (*)	Depletion, Depreciation and Amortization
Three months ended March 31, 2005:			
Pipeline operations	\$ 321,615	(349,604)	81,873
Oil and gas exploration and production	37,415	(16,058)	1,372
Other	-	(650,776)	2,584
	359,030	(1,016,438)	85,829
Other income, net		286,001	
Loss before income taxes		(730,437)	
Three months ended March 31, 2004:			
Pipeline operations	\$ 204,039	(317,915)	81,798
Oil and gas exploration and production	154,892	(63,877)	49,791
Other	-	(188,519)	3,193
	358,931	(570,311)	134,782
Other income, net		50,705	
Loss before income taxes		(519,606)	

	March 31, 2005
Identifiable assets:	
Pipeline operations	\$ 5,637,412
Oil and gas exploration and production	462,470
Other	1,186,264
	\$ 7,286,146
Consolidated	\$ 7,286,146

(\*) Consolidated loss from operations includes \$648,211 and \$185,326 in unallocated general and administrative expenses, and unallocated depletion, depreciation and amortization of \$2,584 and \$3,193 for the three months ended March 31, 2005 and 2004, respectively. All unallocated amounts are included in "Other".



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BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
UNAUDITED - CONTINUED  
MARCH 31, 2005

## 6. STOCK BASED COMPENSATION

We account for stock-based compensation granted under our long-term incentive plans using the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" and related interpretations. Stock-based compensation expense of \$533,445 was recognized in the three months ended March 31, 2005. Recognition of this non-cash expense is required by Financial Accounting Standards Board Interpretation No. 44 "Accounting for Certain Transactions Involving Stock Compensation - An Interpretation of APB Opinion No. 25" ("FIN 44"). Pursuant to FIN 44, stock options exercised in a "cashless" manner by surrendering a portion of the option shares issued to pay the option exercise price, trigger variable accounting treatment, requiring the measurement of compensation expense at a period beyond the date of grant.

In the fiscal quarter ending March 31, 2006, we will begin accounting for stock-based compensation under Statement of Financial Accounting Standards No. 123R "Share-Based Payment." SFAS No. 123R is a revision to Statement of Financial Accounting Standards No. 123 "Accounting for Stock-Based Compensation," and eliminates the ability to account for share-based compensation transactions using APB Opinion No. 25. It requires that such transactions be accounted for using a fair value-based method.

The following table illustrates the effect on net loss and loss per share if we had applied the fair value recognition provisions of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" to stock-based employee compensation:

	Three months ended March 31,	
	RESTATE 2005	2004
	-----	-----
	(in thousands, except per share amounts)	
Net loss, as reported.....	\$ (730)	\$ (520)
Add: Total stock-based employee compensation expense included in reported net loss, net of related tax effects	\$ 533	-
Deduct: Total stock-based employee compensation expense determined under fair value based method for awards, net of related tax effects.....	(66)	-
	-----	-----
Pro forma net loss.....	\$ (263)	\$ (520)
	=====	=====
Net loss per share:		
Basic and Diluted - as reported	\$ (0.03)	\$ (0.08)
	=====	=====
Basic and Diluted - pro forma	\$ (0.03)	\$ (0.08)
	=====	=====

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
UNAUDITED - CONTINUED  
MARCH 31, 2005

During the three months ended March 31, 2005, 156,250 stock options were exercised, with exercise prices ranging from \$.43 per share to \$1.55 per share. At March 31, 2005 there were 280,068 stock options outstanding with exercise prices ranging from \$.35 per share to \$6.00 per share. All of the stock options exercised were done so by using the quoted market value of the shares of common stock issued to pay for the option exercise price. As a result, 27,711 shares of common stock issued were surrendered to us for payment of the option exercise price.

7. EXERCISE OF WARRANTS

As of January 1, 2005, there were 3,100,000 warrants outstanding that were issued pursuant to the Note and Warrant Purchase Agreement dated September 8, 2004. During the three months ended March 31, 2005, 791,666 warrants were exercised.

The exercise of the warrants was accomplished via net exercises, whereby holders surrendered their right to purchase a portion of the shares of common stock, resulting in 47,697 shares of common stock being surrendered to pay for the warrant exercise price and 743,969 shares issued to warrant holders.

Subsequent to March 31, 2005, an additional 1,416,671 warrants were exercised via net exercises, resulting in the issuance of 1,252,347 shares of common stock. As of the filing of this report, there were 891,663 warrants outstanding. The outstanding warrants are fully vested, exercisable at \$.25 per warrant into one share of common stock, and expire between September 8, 2009 and November 30, 2009.

8. RECENT ACCOUNTING DEVELOPMENTS

In December, 2004, the FASB issued SFAS No. 123R, "Share-Based Payment," that addresses the accounting for share-based payment transactions in which a company receives employee services in exchange for equity instruments of the company, such as stock options and restricted stock. SFAS No. 123R eliminates the ability to account for share-based compensation transactions using APB Opinion No. 25 and requires instead that such transactions be accounted for using a fair value-based method. We currently account for stock-based compensation using the intrinsic method pursuant to APB Opinion No. 25. SFAS No. 123R requires that all stock-based payments to employees, including grants of employee stock options and restricted stock, be recognized as compensation expense in the financial statements based on their fair values. Public entities that file as small business issuers will be required to apply Statement 123R in the first interim or annual reporting period that begins after December 15, 2005. Accordingly, we will be required to apply SFAS No. 123R beginning in the fiscal quarter ending March 31, 2006. We are currently assessing the provisions of SFAS No. 123R and its impact on our consolidated financial statements.

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### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

#### CAUTIONARY NOTE REGARDING FORWARD LOOKING STATEMENTS

Forward Looking Statements. Certain of the statements included in this quarterly report on Form 10-QSB, including those regarding future financial performance or results or that are not historical facts, are "forward-looking" statements as that term is defined in Section 21E of the Securities Exchange Act of 1934, as amended, and Section 27A of the Securities Act of 1933, as amended. The words "expect," "plan," "believe," "anticipate," "project," "estimate," and similar expressions are intended to identify forward-looking statements. Blue Dolphin Energy Company (referred to herein, with its predecessors and subsidiaries, as "Blue Dolphin," "we," "us" and "our") cautions readers that these statements are not guarantees of future performance or events and such statements involve risks and uncertainties that may cause actual results and outcomes to differ materially from those indicated in forward-looking statements. Some of the important factors, risks and uncertainties that could cause actual results to vary from forward-looking statements include:

- the level of utilization of our pipelines;
- availability and cost of capital;
- actions or inactions of third party operators for properties where we have an interest;
- the risks associated with exploration;
- the level of production from oil and gas properties;
- gas and oil price volatility;
- uncertainties in the estimation of proved reserves and in the projection of future rates of production and timing of development expenditures;
- regulatory developments; and
- general economic conditions.

Additional factors that could cause actual results to differ materially from those indicated in the forward-looking statements are discussed under the caption "Risk Factors" in our annual report on Form 10-KSB for the year ended December 31, 2004. Readers are cautioned not to place undue reliance on these forward-looking statements which speak only as of the date thereof. We undertake no duty to update these forward-looking statements. Readers are urged to carefully review and consider the various disclosures made by us which attempt to advise interested parties of the additional factors which may affect our business, including the disclosures made under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations" in this report.

#### BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - CONTINUED

#### EXECUTIVE SUMMARY

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We are engaged in two lines of business: (i) pipeline transportation services to producer/shippers, and (ii) oil and gas exploration and production. We conduct our operations through our subsidiaries and our assets are located offshore and onshore in the Texas Gulf coast area. In addition to satisfying our liquidity and capital needs, our focus in 2005 is to increase utilization of our pipelines, strategic acquisitions and cost management. Our long-term goal is to create greater value for our stockholders through the addition of assets. Although we continue to have interest in oil and gas properties and will consider acquiring interests in producing oil and gas properties, as a result of implementing cost savings measures in 2004 we are primarily focused on our pipeline business.

At the beginning of 2004 we faced a significant liquidity shortage. We estimated that we would need to raise approximately \$1,500,000 to satisfy our liquidity and working capital requirements through 2004. To address our liquidity shortage in 2004 we:

- Implemented cost savings measures in mid 2004 that included, among other things, reducing the number of employees and contract personnel, resulting in expected annual cost savings of approximately \$360,000,
- Extended the payment terms of \$668,000 of indebtedness that was due in August and September 2004, to now be payable over a twelve month period from September 2004 through August 2005,
- Raised capital through the issuance of \$750,000 of promissory notes in September 2004,
- Sold our interest in New Avoca Gas Storage, LLC for approximately \$930,000 in October 2004, and
- Negotiated an increase in gas transportation rates on the Blue Dolphin System effective October 2004, that provided additional revenues of approximately \$210,000 and \$150,000 in the fourth quarter 2004 and the first quarter 2005, respectively.

As a result of our ongoing liquidity problems, our auditors UHY Mann Frankfort Stein & Lipp CPAs, LLP added an explanatory paragraph in their opinion on our consolidated financial statements as of the year ended December 31, 2004, indicating that substantial doubt exists about our ability to continue as a going concern. At the beginning of 2005, we estimated that we would need to raise approximately \$500,000 to satisfy our liquidity and working capital requirements through 2005.

Although we have not raised capital in 2005, we have been able to work with our creditors and restructure the terms of our indebtedness. As a result of these and other actions taken in 2004, we now believe that we have sufficient liquidity and working capital at March 31, 2005 to satisfy our requirements through March 31, 2006.

### BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

#### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - CONTINUED

##### LIQUIDITY AND CAPITAL RESOURCES

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While we have been able to implement cost savings measures and restructure the terms of some of our indebtedness we were not able to generate sufficient cash from operations to cover operating costs and general and administrative expenses. Furthermore, our financial condition has been significantly and negatively affected by the poor performance of our businesses and our significant indebtedness. For the three months ended March 31, 2005, we generated total revenues of approximately \$360,000 while operating costs and general and administrative expenses, totaled approximately \$1,265,000, including non-cash compensation expense of \$533,445 associated with cashless exercises of stock options.

In August 2004, we extended the remaining payments totaling \$668,000 due in September and October 2004 to Tetra Applied Technologies, Inc. ("Tetra") for the abandonment/reefing of the Buccaneer Field. Under the revised terms, on September 1, 2004 we began paying Tetra the outstanding balance in twelve monthly installments of \$55,667 plus interest on the outstanding balance at the rate of six percent per annum. As of March 31, 2005, the remaining balance due Tetra was approximately \$280,000.

On September 8, 2004, we entered into a Note and Warrant Purchase Agreement ("Purchase Agreement") with certain accredited investors and certain of our directors for the purchase and sale of promissory notes in an aggregate principal amount of \$750,000 (the "Promissory Notes") and 2,800,000 warrants ("Warrants") to purchase shares of our common stock at a purchase price of \$0.003 per Warrant. The sale of the Promissory Notes and the first tranche of 1,250,000 initial Warrants closed on September 8, 2004, and the closing of the sale of the second tranche of 1,550,000 additional Warrants closed on November 30, 2004 after we received stockholder approval of the issuance of the additional Warrants at our November 11, 2004 special stockholders meeting. We received proceeds of \$758,400 from the issuance of the Promissory Notes and the Warrants. The Promissory Notes mature on September 8, 2005, and accrue interest at a rate of 12.0% per annum, of which 4% is payable monthly and 8% is payable at maturity. However, in April 2005, the holders of \$450,000 aggregate principal amount of Promissory Notes agreed to extend the maturity date of their Promissory Notes to June 30, 2006 and to defer the payment of all interest on their Promissory Notes until maturity. In exchange for extending the maturity of the Promissory Notes, we waived compliance with the lock-up provisions of the Purchase Agreement allowing them to sell shares of our common stock that they may receive upon exercise of their Warrants, and to accelerate the date we are required to file a registration statement registering the resale of their shares of common stock that they may acquire upon exercise of Warrants to May 15, 2005. As of March 31, 2005, we issued 743,969 shares of common stock as a result of the exercise of Warrants, and in April and May 2005, we issued an additional 1,252,347 shares of common stock as a result of the exercise of Warrants. The exercise of the Warrants was accomplished via net exercises, whereby holders surrendered their right to receive 212,021 shares of common stock. We filed a Form S-3 registration statement with the Securities and Exchange Commission on May 12, 2005 to register the shares of common stock that were issued pursuant to the exercise of warrants and shares that are issuable upon exercise of warrants.

In October 2004, we sold our 25% equity interest in New Avoca. Pursuant to the terms of a Purchase and Sale Agreement, we received approximately \$930,000 for our interest in New Avoca, and may receive an additional payment of up to approximately \$375,000, subject to the commencement of commercial operations at the New Avoca natural gas storage facility prior to October 29, 2011. The proceeds from the sale of our interest in New Avoca is being used for general corporate purposes.

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## BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - CONTINUED

The following table summarizes certain of our contractual obligations and other commercial commitments at March 31, 2005 (amounts in thousands):

Contractual Obligations and Other Commercial Commitments	Payments Due by Period			
	Total	1 year or less	1-3 years	3-5 y
Accounts Payable - Tetra	\$ 278	278	-	
Notes Payable and Long-Term Debt	1,506	445	1,061	
Operating Leases, net of sublease	215	120	91	
Abandonment - Costs	1,646	-	191	
<b>Total Contractual Obligations and Other Commercial Commitments</b>	<b>\$ 3,645</b>	<b>843</b>	<b>1,343</b>	

The following table summarizes our financial position for the periods indicated (amounts in thousands):

	RESTATED March 31, 2005		December 31, 2004	
	Amount	%	Amount	%
Working Capital	\$ 697	12	\$ 404	7
Property and equipment, net	5,167	88	5,324	93
Other noncurrent assets	11	-	11	-
<b>Total</b>	<b>\$ 5,875</b>	<b>100</b>	<b>\$ 5,739</b>	<b>100</b>
Long-term Liabilities	\$ 2,707	46	\$ 2,374	41
Stockholders' equity	3,168	54	3,365	59
<b>Total</b>	<b>\$ 5,875</b>	<b>100</b>	<b>\$ 5,739</b>	<b>100</b>

Our financial position did not significantly change from December 31, 2004 to March 31, 2005.

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### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - CONTINUED

Natural gas transportation throughput on our Blue Dolphin System is currently 6 MMBtu per day representing 4% of system capacity. We have significant available capacity in our Blue Dolphin Pipeline System in a market area that we believe is experiencing an increased level of interest by oil and gas operators. Effective October 1, 2004, we renegotiated the gas transportation rates on the Blue Dolphin System due to operating losses incurred from operating the system. As a result, first quarter 2005 gas transportation revenues from the Blue Dolphin System totaled approximately \$209,000. Without the increased rates, gas transportation revenues would have been approximately \$60,000 for this same period. Future utilization of our pipelines and related facilities will depend upon the success of drilling programs around our pipeline systems, and attraction and retention of producer/shippers to the systems. Two new successful wells have recently been drilled in lease blocks in the vicinity of the Blue Dolphin Pipeline. As a result of current and anticipated drilling activity around the Blue Dolphin System, we expect that utilization of the Blue Dolphin System will increase in late 2005.

On February 28, 2005 (effective as of January 1, 2005), we entered into an amendment to our purchase agreement with MCNIC Pipeline and Processing Group, Inc. ("MCNIC"). Under the terms of the original purchase agreement, we acquired MCNIC's one-third interests in both the Blue Dolphin System and the inactive Omega Pipeline. Pursuant to the terms of the amendment, the original promissory note was exchanged for a new promissory note, and all accrued interest on the original promissory note was forgiven, approximately \$132,000. In addition to the new promissory note, MCNIC can receive additional payments of up to \$500,000 from 50% of the net profits, if any, realized from the one-third interest in the Blue Dolphin System through December 31, 2006. We made a principal payment on the new promissory note of \$30,000 upon the execution of the amendment. Under the terms of the new promissory note, we will make monthly principal payments of \$10,000 through its maturity date of December 31, 2006. The principal amount of the new promissory note may be increased by up to \$500,000, if 50% or more of our 83% interest in the Blue Dolphin System is sold before December 31, 2006.

During the three months ended March 31, 2005, we incurred no capital expenditures for the development of our proved reserves. However, we do expect to make capital expenditures totaling \$13,000 and \$203,000 in the years ending December 31, 2005 and 2007, respectively. Capital expenditures in 2005 represent workover costs, net to our interest, for the producing well in the High Island Block A-7 field and in 2007, the abandonment costs of our High Island Block A-7 field, net to our interest.

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### BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - CONTINUED

#### RESULTS OF OPERATIONS

We reported a net loss for the three months ended March 31, 2005 ("current period") of \$730,437 compared a net loss of \$519,606 reported for the three months ended March 31, 2004 ("previous period").

Revenue from pipeline operations. Revenues from pipeline operations increased by \$117,576 or 58% in the current period to \$321,615. Revenues in the current period from the Blue Dolphin System totaled approximately \$253,000 compared to

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approximately \$134,000 in the previous period primarily as a result of an increase in our average gas transportation rates on the Blue Dolphin System effective as of October 2004. The increased rates will decrease as our net operating results from the Blue Dolphin System improve, but in any case, the rates will be no lower than the rates that were in effect prior to October 2004.

Revenue from oil and gas sales. Revenues from oil and gas sales decreased by \$117,477 in the current period from those of the previous period primarily due to a significant production decline in the High Island Block A-7 field, which provided revenues from oil and gas sales of approximately \$37,000 in the current period compared to approximately \$118,000 in the previous period. We expect that production from the reservoir currently producing will cease in mid 2005. However there is an additional reservoir in which a recompletion in the existing well is possible. Oil and gas sales from this additional reservoir are not expected to significantly increase our total revenues in 2005. Previous period oil and gas sales include approximately \$36,000 from our interest in the High Island Block 34 field, which was sold in June 2004.

Pipeline operating expenses. Pipeline operating expenses in the current period increased by \$44,609 to \$287,860 due to an increase in legal costs of approximately \$94,000 and other expenses of approximately \$20,000, offset in part by a decrease of approximately \$70,000 in insurance costs due to a refund received for having no claims in the previous policy period and the elimination of property insurance coverage on our pipelines in mid 2004. The legal costs are associated with an action filed against us, the outcome of which we do not believe will have a material impact. However, as this litigation continues we will continue to incur significant legal expenses which could have a material adverse effect on our financial condition.

General and administrative. General and administrative expenses increased by \$464,726 to \$960,740 in the current period. The increase was due to recognition of \$533,445 of non-cash compensation expense associated with "cashless" exercises of 156,250 stock options by certain of our directors and employees during the period, offset by lower personnel and other costs as a result of our cost reduction plans implemented in 2003 and 2004. The 2004 cost reductions included the termination of certain employees in mid 2004. The annual cost savings associated with measures taken is expected to be approximately \$360,000. If our business activities expand, we will need to hire additional employees, and personnel and associated costs will increase.

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### BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

#### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - CONTINUED

Depletion, depreciation and amortization. Depletion, depreciation and amortization expense decreased by \$48,953 in the current period to \$85,829. In the previous period we recorded depletion of approximately \$38,000 associated with our oil and gas properties, while we had none in the current period. The decrease in depletion was a result of there being no remaining unamortized oil and gas costs in the current period.

Interest and other expense. Interest and other expense increased \$27,745 in the current period. Interest expense in the current period increased by approximately \$16,000 due to the issuance of the Promissory Notes in September 2004. Other expense in the current period increased by approximately \$11,000 due to the amortization of debt issuance costs.

Interest and other income. Interest and other income increased \$239,739 in the



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current period. Other income in the current period includes a gain of the placement of our interests in the Galveston Block 287/297 leases of approximately \$140,000, a gain on the elimination of accrued interest pursuant to the restructuring of the MCNIC promissory note of approximately \$132,000 and the collection of accounts receivable that were previously written off of approximately \$45,000. Other income in the previous period includes fees generated for consulting services we provided, associated with the evaluation of oil and gas properties of \$50,000 and the collection of accounts receivable that were previously written off of \$30,000.

Equity in loss of affiliate. In the previous period we recorded a loss from our equity interest in New Avoca of \$23,302. Our interest in New Avoca was sold in October 2004.

### RECENT ACCOUNTING DEVELOPMENTS

See Note 8 in Item 1.

### ITEM 3. CONTROLS AND PROCEDURES

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Principal Accounting and Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act). Based upon this evaluation, the Chief Executive Officer and Principal Accounting and Financial Officer concluded that our disclosure controls and procedures were effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act, are recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

Subsequent to the filing of the Form 10-QSB/A for the period ending March 31, 2005, it was determined that the adequacy of our disclosure controls and procedures was impacted by a deficiency in our internal control over financial reporting with respect to the application of generally accepted accounting principles ("GAAP") to the "cashless" exercise of stock options by certain directors and employees. We account for stock-based compensation as fixed awards under the Intrinsic Value Method as prescribed by Accounting Principles Board Opinion No. 25 "Accounting for Stock Issued to Employees" ("APB No. 25"). Under

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### BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

#### ITEM 3. CONTROLS AND PROCEDURES - CONTINUED

APB No. 25, the compensation expense associated with option grants that receive fixed accounting treatment is measured at the grant date. When variable accounting treatment is applied, compensation expense is measured again and recognized at periods after the initial measurement date. We have concluded, after consultation with UHY, that options exercised in the first and second quarters of 2005 using the "cashless" exercise method require variable accounting treatment under Financial Accounting Standards Board Interpretation No. 44 "Accounting for Certain Transactions Involving Stock Compensation - An Interpretation of APB Opinion No. 25" ("FIN 44"). The error in our reporting of compensation expense which was discovered after the filing of the Quarterly Report for the quarter ended June 30, 2005, resulted in the restatement of the financial information for the quarter ended March 31, 2005, as described in Part I, Item 1, Note 6. "Stock Based Compensation" to the condensed interim consolidated financial statements included in this Form 10-QSB/A.

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Management had previously concluded that our disclosure controls and procedures were effective as of March 31, 2005 and reported that there was no change in our internal control over financial reporting that occurred during the quarter ended March 31, 2005 that materially affected, or was reasonably likely to materially affect, the internal control over financial reporting. However, upon discovery of this error in application of GAAP, management has concluded that a significant deficiency existed in our internal control over financial reporting with respect to the application of GAAP to our financial statements and our disclosure controls and procedures were not effective as of March 31, 2005.

In response to the identified deficiency, we have taken remedial steps to improve the control processes regarding the application of GAAP and preparation and review of the consolidated financial statements. Specifically, key personnel involved in our financial reporting process have enhanced the process through which authoritative guidance will be monitored on a regular basis. On-going reviews of authoritative guidance are being conducted in order to ensure that the guidance is being complied with in the preparation of the financial statements, related disclosures and periodic filings with the SEC. In the beginning of the third quarter prior to the filing of the 10-QSB for the second quarter, we also implemented changes in our internal controls over financial reporting in the form of more in-depth project status review procedures. All of these changes were designed to enhance our existing disclosure controls and procedures. Other than the changes discussed above, there have been no changes made in our internal control over financial reporting that materially affected, or is reasonably likely to materially affect, the internal control over financial reporting.

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### BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

#### PART II. OTHER INFORMATION

##### ITEM 6. EXHIBITS

###### A) Exhibits

- 3.1(1) Amended and Restated Certificate of Incorporation of the Company.
- 3.2(2) Amended and Restated Bylaws of the Company.
- 31.1 Ivar Siem Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Gregory W. Starks Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Ivar Siem Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Gregory W. Starks Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002.

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- (1) Incorporated herein by reference to Exhibits filed in connection with the definitive Proxy Statement of Blue Dolphin Energy Company under the Securities and Exchange Act of 1934, dated October 13, 2004 (Commission File No. 000-15905).
- (2) Incorporated herein by reference to Exhibits filed in connection with Form 10-QSB of Blue Dolphin Energy Company for the quarter ended June 30, 2004 under the Securities and Exchange Act of 1934, dated August 20, 2004 (Commission File No. 000-15905).

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BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

By: BLUE DOLPHIN ENERGY COMPANY

Date: November 10, 2005

/s/ Ivar Siem

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Ivar Siem  
Chairman and Chief Executive Officer

/s/ Gregory W. Starks

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Gregory W. Starks  
Treasurer  
(Principal Accounting and Financial Officer)

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INDEX TO EXHIBITS

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