

BLUE DOLPHIN ENERGY CO  
Form 10-Q  
May 15, 2013

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended: March 31, 2013

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 registrant as specified in its charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)

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

801 Travis Street, Suite 2100, Houston, Texas 77002  
(Address of principal executive offices)

(713) 568-4725  
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) 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 whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

Non-accelerated filer  Smaller reporting company   
(Do not check if a smaller reporting company)

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

Number of shares of common stock, par value \$0.01 per share issued as of May 15, 2013: 10,571,629

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## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

## BLUE DOLPHIN ENERGY COMPANY &amp; SUBSIDIARIES

## Condensed Consolidated Balance Sheets (Unaudited)

	March 31, 2013	December 31, 2012
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$88,059	\$420,896
Restricted cash	27,348	89,593
Accounts receivable, net	10,510,790	15,398,755
Prepaid expenses and other current assets	208,959	228,314
Deposits	1,245,910	1,236,447
Inventory	3,789,792	2,300,692
Total current assets	15,870,858	19,674,697
Total property and equipment, net	36,063,523	35,862,085
Debt issue costs, net	523,885	532,335
Other assets	-	9,463
Trade name	303,346	303,346
<b>TOTAL ASSETS</b>	<b>\$52,761,612</b>	<b>\$56,381,926</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable	\$16,292,668	\$19,171,013
Accounts payable, related party	2,178,061	1,594,021
Note payable	9,348,518	43,941
Asset retirement obligations, current portion	90,601	-
Accrued expenses and other current liabilities	895,202	725,238
Interest payable, current portion	637,551	640,352
Long-term debt, current portion	1,485,000	1,816,960
Total current liabilities	30,927,601	23,991,525
Long-term liabilities:		
Asset retirement obligations, net of current portion	855,823	921,260
Long-term debt, net of current portion	4,960,584	13,989,517
Long-term interest payable, net of current portion	910,071	858,784
Total long-term liabilities	6,726,478	15,769,561
<b>TOTAL LIABILITIES</b>	<b>37,654,079</b>	<b>39,761,086</b>
<b>STOCKHOLDERS' EQUITY</b>		

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Common stock (\$0.01 par value, 20,000,000 shares authorized, 10,571,629 and 10,563,297 shares issued at March 31, 2013 and December 31, 2012, respectively)	105,717	105,633
Additional paid-in capital	36,574,059	36,524,142
Accumulated deficit	(20,772,243)	(20,008,935)
Treasury stock, 150,000 and 0 shares, respectively, at cost	(800,000 )	-
Total stockholders' equity	15,107,533	16,620,840
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$52,761,612</b>	<b>\$56,381,926</b>

See accompanying notes to condensed consolidated financial statements.

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## BLUE DOLPHIN ENERGY COMPANY &amp; SUBSIDIARIES

## Condensed Consolidated Statements of Operations (Unaudited)

	Three Months Ended March	
	31,	2012
	2013	
<b>REVENUE FROM OPERATIONS</b>		
Refined product sales	\$109,171,507	\$45,770,963
Pipeline operations	73,148	69,910
Oil and gas sales	-	6,056
<b>Total revenue from operations</b>	<b>109,244,655</b>	<b>45,846,929</b>
<b>COST OF OPERATIONS</b>		
Cost of refined products sold	106,322,661	45,641,226
Refinery operating expenses	2,745,209	1,062,751
Pipeline operating expenses	45,371	109,618
Lease operating expenses	26,901	19,338
General and administrative expenses	484,564	525,587
Depletion, depreciation and amortization	328,788	255,753
Abandonment expense	27,451	-
Accretion expense	25,164	21,561
<b>Total cost of operations</b>	<b>110,006,109</b>	<b>47,635,834</b>
<b>Loss from operations</b>	<b>(761,454 )</b>	<b>(1,788,905 )</b>
<b>OTHER INCOME (EXPENSE)</b>		
Net tank rental revenue	278,350	93,955
Interest and other income	835	1,650
Interest expense	(281,063 )	(233,517 )
Total other expense	(1,878 )	(137,912 )
<b>Loss from continuing operations before income taxes</b>	<b>(763,331 )</b>	<b>(1,926,817 )</b>
<b>Tax expense</b>		
Current	-	(30,563 )
Deferred	-	-
Income tax expense	-	(30,563 )
<b>Loss from continuing operations, net of tax</b>	<b>(763,331 )</b>	<b>(1,957,380 )</b>
<b>Loss from discontinued operations, net of tax</b>	<b>-</b>	<b>(12,514 )</b>
<b>Net loss</b>	<b>\$(763,331 )</b>	<b>\$(1,969,894 )</b>
<b>Basic loss per common share</b>		
Continuing operations	\$(0.07 )	\$(0.21 )
Discontinued operations	\$-	\$-

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Basic loss per common share	\$ (0.07	)	\$ (0.21	)
Diluted loss per common share				
Continuing operations	\$ (0.07	)	\$ (0.21	)
Discontinued operations	\$-		\$-	
Diluted loss per common share	\$ (0.07	)	\$ (0.21	)
Weighted average number of common shares outstanding:				
Basic	10,510,334		9,476,748	
Diluted	10,510,334		9,476,748	

See accompanying notes to condensed consolidated financial statements.

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## BLUE DOLPHIN ENERGY COMPANY &amp; SUBSIDIARIES

## Condensed Consolidated Statements of Cash Flows (Unaudited)

	Three Months Ended March 31,	
	2013	2012
<b>OPERATING ACTIVITIES</b>		
Net loss	\$(763,331 )	\$(1,969,894 )
Loss from discontinued operations	-	12,514
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depletion, depreciation and amortization	328,788	252,898
Unrealized loss on derivatives	52,050	-
Amortization of debt issue costs	8,450	8,449
Amortization of intangible assets	9,463	2,855
Accretion expense	25,164	21,561
Abandonment costs incurred	27,451	(110 )
Common stock issued for services	50,000	20,000
Changes in operating assets and liabilities (net of effects of acquisition in 2012)		
Restricted cash	62,245	(151 )
Accounts receivable	4,087,965	(15,923,454)
Prepaid expenses and other current assets	19,355	(57,513 )
Deposits	(9,463 )	(667,421 )
Inventory	(1,489,100)	(554,441 )
Accounts payable, accrued expenses and other liabilities	(2,739,371)	16,010,675
Accounts payable, related party	584,040	1,253,764
Net cash provided by (used in) operating activities - continuing operations	253,705	(1,590,268 )
Net cash provided by operating activities - discontinued operations	-	11,909
Net cash provided by (used in) operating activities	253,705	(1,578,359 )
<b>INVESTING ACTIVITIES</b>		
Capital expenditures	(530,226 )	(1,349,332 )
Cash acquired on acquisition	-	1,674,594
Net cash provided by (used in) investing activities	(530,226 )	325,262
<b>FINANCING ACTIVITIES</b>		
Proceeds from issuance of debt	-	2,364,012
Payments on long-term debt	(60,876 )	(2,916 )
Proceeds from notes payable	15,031	-
Payments on notes payable	(10,472 )	-
Net cash provided by (used in) financing activities	(56,316 )	2,361,096
Net increase (decrease) in cash and cash equivalents	(332,837 )	1,107,999
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	420,896	1,822
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$88,059	\$1,109,821

## Supplemental Information:

Non-cash operating activities



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Reduction in accounts receivable in exchange for treasury stock received	\$800,000	\$-
Non-cash investing and financing activities		
Related party payable converted to equity	\$-	\$993,732
Acquisition of Blue Dolphin at fair value, inclusive of cash acquired of \$1,674,594	\$-	\$18,046,154
Shares issued for services	\$50,000	\$40,000

See accompanying notes to condensed consolidated financial statements.

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Blue Dolphin Energy Company & Subsidiaries  
Notes to Consolidated Financial Statements  
(Continued)

(1) Organization

Blue Dolphin Energy Company (referred to herein, with its predecessors and subsidiaries, as “Blue Dolphin,” “we,” “us” and “our”) is a Delaware corporation that was formed in 1986 as a holding company. We are primarily an independent refiner and marketer of petroleum products. As part of our refining business segment we also conduct petroleum storage and terminaling operations. These operations involve the storage of petroleum under third-party lease agreements at the Nixon Facility. We also own and operate pipeline assets and have leasehold interests in oil and gas properties. See “Note (6) Business Segment Information” for further discussion of our business segments.

We conduct substantially all of our operations through our wholly-owned subsidiaries. Our operating subsidiaries include:

Lazarus Energy, LLC (“LE”), a Delaware limited liability company (petroleum processing assets);  
Lazarus Refining & Marketing, LLC (“LRM”), a Delaware limited liability company (petroleum storage and terminaling);  
Blue Dolphin Pipe Line Company, a Delaware corporation (pipeline operations);  
Blue Dolphin Petroleum Company, a Delaware corporation (exploration and production activities);  
Blue Dolphin Services Co., a Texas corporation (administrative services);  
Blue Dolphin Exploration Company (“BDEX”), a Delaware corporation (exploration and production investment); and  
Petroport, Inc., a Delaware corporation (inactive).

(2) Basis of Presentation

We have prepared our unaudited consolidated financial statements in accordance with U.S. generally accepted accounting principles (“GAAP”), as codified by the Financial Accounting Standards Board (the “FASB”) in its Accounting Standards Codification (“ASC”), and pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”). The consolidated financial statements include Blue Dolphin and its subsidiaries. Significant intercompany transactions have been eliminated in the consolidation. In the opinion of management, such consolidated financial statements reflect all adjustments necessary to present fair consolidated statements of operations, financial position and cash flows. We believe that the disclosures are adequate and the presented information is not misleading. This report has been prepared in accordance with the SEC’s Form 10-Q instructions and therefore, certain information and footnote disclosures normally included in our annual audited financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to the SEC’s rules and regulations.

Operations associated with the North Sumatra Basin – Langsa Field offshore Indonesia (“Indonesia”), which were previously reported as part of our Oil and Gas Exploration & Production business segment, have been presented as discontinued operations in the condensed consolidated financial statements. See “Note (14) Discontinued Operations” for additional information regarding these discontinued operations. Unless stated otherwise, any reference to income statement items in these financial statements refers to results from continuing operations.

(3) Significant Accounting Policies

The summary of significant accounting policies of Blue Dolphin is presented to assist in understanding our consolidated financial statements. The consolidated financial statements and notes are representations of our management who is responsible for their integrity and objectivity. These accounting policies conform to generally

accepted accounting principles and have been consistently applied in the preparation of the consolidated financial statements.

#### Use of Estimates

We have made a number of estimates and assumptions related to the reporting of our consolidated assets and liabilities and to the disclosure of contingent assets and liabilities to prepare these audited consolidated financial statements in conformity with GAAP. While we believe current estimates are reasonable and appropriate, actual results could differ from those estimated.

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Blue Dolphin Energy Company & Subsidiaries  
Notes to Consolidated Financial Statements  
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Cash and Cash Equivalents

Cash equivalents include liquid investments with an original maturity of three months or less. Cash balances are maintained in depository and overnight investment accounts with financial institutions that, at times, exceed insured limits. We monitor the financial condition of the financial institutions and have experienced no losses associated with these accounts.

Restricted Cash

Restricted cash was \$27,348 and \$89,593 at March 31, 2013 and December 31, 2012, respectively. These amounts relate to escrow accounts for potential environmental matters and loan repayments.

Accounts Receivable, Allowance for Doubtful Accounts and Concentrations of Credit Risk

Accounts receivable are customer obligations due under normal trade terms. The allowance for doubtful accounts represents our estimate of the amount of probable credit losses existing in our accounts receivable. We have a limited number of customers with individually large amounts due at any given date. Any unanticipated change in any one of these customers' credit worthiness or other matters affecting the collectability of amounts due from such customers could have a material adverse effect on our results of operations in the period in which such changes or events occur. We regularly review all of our aged accounts receivables for collectability and establish an allowance as necessary for individual customer balances.

Concentration of Risk

Financial instruments that potentially subject us to concentrations of credit risk consist primarily of cash, trade receivables and payables. We maintain our cash balances at banks located in Houston, Texas. Accounts in the United States are insured by the Federal Deposit Insurance Corporation up to \$250,000. We had uninsured balances of \$0 and \$170,896 at March 31, 2013 and December 31, 2012, respectively.

We had four customers that accounted for approximately 81% of our total revenue for the three months ended March 31, 2013. These four customers represented approximately \$7.5 million of accounts receivable at March 31, 2013.

Inventory

Our inventory primarily consists of refined petroleum products valued at lower of cost or market with costs being determined by the average cost method.

Price-Risk Management Activities

We utilize an inventory risk management policy under which Genesis Energy, LLC ("Genesis") may, but is not required to, use derivative instruments as economic hedges to reduce refined petroleum products and crude oil inventory commodity price risk. We follow FASB ASC guidance for derivatives and hedging related to stand alone derivative instruments. These contracts are not subject to hedge accounting treatment under FASB ASC guidance. Accordingly, even though such hedge positions are direct contractual obligations of Genesis and not us, we nevertheless record the fair value of these Genesis hedges in our condensed consolidated balance sheet each quarter because of contractual

arrangements between Genesis and us under which we are effectively exposed to the potential gains or losses. Changes in the fair value from quarter to quarter are recognized in our condensed consolidated statement of operations.

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Blue Dolphin Energy Company & Subsidiaries  
Notes to Consolidated Financial Statements  
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Property and Equipment

Refinery and Facilities. Additions to refinery and facilities are capitalized. Expenditures for repairs and maintenance, including maintenance turnarounds, are charged to expense as incurred. Management expects to continue making improvements to our refinery assets based on technological advances.

Refinery and facilities are carried at cost. Adjustment of the asset and the related accumulated depreciation accounts are made for refinery and facilities' retirements and disposals, with the resulting gain or loss included in the statements of operations.

For financial reporting purposes, depreciation of refinery and facilities is computed using the straight-line method over the estimated useful lives of 25 years when the refinery and facilities are placed in service.

Management has evaluated the FASB ASC guidance related to asset retirement obligations ("AROs") for our refinery and facilities. Management has concluded that there is no legal or contractual obligation to dismantle or remove the refinery and facilities. Further, management believes that these assets have indeterminate lives under FASB ASC guidance for estimating AROs because dates or ranges of dates upon which we would retire these assets cannot reasonably be estimated at this time. When a date or range of dates can reasonably be estimated for the retirement of these assets, we will estimate the cost of performing the retirement activities and record a liability for the fair value of that cost using present value techniques. We did not record any impairment of our refinery and facilities for the three months ended March 31, 2013 and 2012.

Oil and Gas Properties. We account for our oil and gas properties using the full-cost method of accounting, whereby all costs associated with acquisition, exploration and development of oil and gas properties, including directly related internal costs, are capitalized on a cost center basis. Amortization of such costs and estimated future development costs are determined using the unit-of-production method. Our U.S. Gulf of Mexico oil and gas properties were uneconomical for the twelve months ended December 31, 2012 due to leases being relinquished and fields being shut-in by operators. We disposed of our operations in Indonesia in 2012. The estimated fair values of our AROs related to our oil and gas properties were recorded at February 15, 2012 in connection with our acquisition of LE.

Pipelines and Facilities Assets. Pipelines and facilities assets have historically been recorded at cost. Following the impairment of our pipeline fixed assets for the twelve months ended December 31, 2012, we record pipelines and facilities assets at the lower of cost or net realizable value. Depreciation is computed using the straight-line method over estimated useful lives ranging from 10 to 22 years. In accordance with FASB ASC guidance on accounting for the impairment or disposal of long-lived assets, assets are grouped and evaluated for impairment based on the ability to identify separate cash flows generated therefrom. The estimated fair values of our AROs related to our pipeline and facilities assets were recorded at February 15, 2012 in connection with our acquisition of LE.

Construction in Progress. Construction in progress expenditures related to refurbishment activities at our petroleum refinery located in Nixon, Wilson County, Texas (the "Nixon Facility") are capitalized as incurred. Depreciation begins once the asset is placed in service.

Intangibles – Goodwill and Other

Goodwill. We recognized goodwill in connection with our reverse merger with LE. Goodwill has an indefinite useful life and represents the difference between the total purchase price and the fair value of assets (tangible and intangible) and liabilities at the date of acquisition is reviewed for impairment annually, and more frequently as circumstances warrant, and written down only in the period in which the recorded value of such assets exceed their fair value. We do not amortize goodwill in accordance with FASB Accounting Standards Codification (“ASC”) guidance related to intangibles, goodwill and other. We perform an impairment test annually.

Goodwill is tested for impairment at the reporting unit level, which is defined as an operating segment or a component of an operating segment that constitutes a business for which discrete financial information with similar economic characteristics is available and the operating results are regularly reviewed by management. Our pipeline transportation and oil and gas exploration and production business segments comprise the reporting units for goodwill impairment testing purposes.

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Blue Dolphin Energy Company & Subsidiaries  
Notes to Consolidated Financial Statements  
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In 2012, we adopted FASB Accounting Standards Updates (“ASU”) related to testing goodwill for impairment,” in connection with the performance of our annual goodwill impairment testing. Under the ASU guidance, entities are provided with the option of first performing a qualitative assessment on none, some or all of its reporting units to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying value. If after completing a qualitative analysis, it is determined that it is more likely than not that the fair value of a reporting unit is less than its carrying value a quantitative analysis is required.

The quantitative goodwill impairment analysis is a two-step process. We performed step one quantitative testing for our pipeline transportation and oil and gas exploration and production business segments in 2012. The first step used to identify potential impairment involves comparing each reporting unit’s estimated fair value to its carrying value, including goodwill. During the first step, we evaluated goodwill for impairment using a business valuation method, which is calculated as of a measurement date by determining the present value of debt-free, after-tax projected future cash flows, discounted at the weighted average cost of capital of a hypothetical third party buyer. Our analysis indicated an impairment in 2012.

The second step of the process involves the calculation of an implied fair value of goodwill for each reporting unit for which step one indicated impairment. The implied fair value of goodwill is determined by measuring the excess of the estimated fair value of the reporting unit over the estimated fair values of the individual assets, liabilities and identifiable intangibles as if the reporting unit was being acquired in a business combination. If the implied fair value of goodwill exceeds the carrying value of goodwill assigned to the reporting unit, there is no impairment. If the carrying value of goodwill assigned to a reporting unit exceeds the implied fair value of the goodwill, an impairment charge is recorded for the excess. An impairment loss cannot exceed the carrying value of goodwill assigned to a reporting unit and the subsequent reversal of goodwill impairment losses is not permitted. The determination of fair value required us to make significant estimates and assumptions. These estimates and assumptions primarily included, but were not limited to, revenue growth and operating earnings projections, discount rates, growth rates and required capital expenditure projections. Due to the inherent uncertainty involved in making these estimates, actual results could have differed materially from our estimates. As a result of our evaluation, we recognized a non-cash impairment charge of \$1,445,720 related to goodwill for the twelve months ended December 31, 2012. The impairment recognized for the twelve months ended December 31, 2012 represented 100% of goodwill.

**Other Intangible Assets.** We recognized trade name in connection with our reverse merger with LE. We have determined our trade name to have an indefinite useful life. We account for other intangible assets under FASB ASC guidance related to intangibles, goodwill and other. Under the guidance, intangible assets with indefinite lives are tested annually for impairment. Management performed its regular annual impairment testing of trade name following FASB ASC guidance for determining impairment. Upon completion of that testing, we determined that no impairment was necessary as of December 31, 2012.

**Debt Issue Costs**

We have debt issue costs related to certain of our debt. Debt issue costs are capitalized and amortized over the term of the related debt using the straight-line method, which approximates the effective interest method. When a loan is paid in full, any unamortized financing costs are removed from the related accounts and charged to operations.

Debt issue costs, net of accumulated amortization, totaled \$523,885 and \$532,335 at March 31, 2013 and December 31, 2012, respectively. Accumulated amortization was \$152,095 and \$143,645 at March 31, 2013 and December 31,



2012, respectively, and is being amortized over the life of the Refinery Loan. Amortization expense, which is included in interest expense, was \$8,450 for the three months ended March 31, 2013 and 2012. See “Note (16) Notes Payable” of this report for additional disclosures related to the Refinery Loan.

#### Revenue Recognition

Refined Petroleum Products Revenue. We sell various refined petroleum products including naphtha, distillates and atmospheric gas oil. Revenue from refined product sales is recognized when title passes. Title passage occurs when refined petroleum products are sold or delivered in accordance with the terms of the respective sales agreements. Revenue is recognized when sales prices are fixed or determinable and collectability is reasonably assured.

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Customer assume the risk of loss when title is transferred. Transportation, shipping and handling costs incurred are included in cost of refined petroleum products sold. Excise and other taxes that are collected from customers and remitted to governmental authorities are not included in revenue.

Tank Storage Rental Revenue. Revenue from tank storage rental is recorded on a straight line basis in accordance with the terms of the related lease agreement. The lessee is invoiced monthly for the amount of rent due for the related period.

Recognition of Oil and Gas Revenue. Sales from producing wells are recognized on the entitlement method of accounting, which defers recognition of sales when, and to the extent that, deliveries to customers exceed our net revenue interest in production. Similarly, when deliveries are below our net revenue interest in production, sales are recorded to reflect the full net revenue interest. Our imbalance liability at March 31, 2013 was not material.

Pipeline Transportation Revenue. Revenue from our pipeline operations is derived from fee-based contracts and is typically based on transportation fees per unit of volume transported multiplied by the volume delivered. Revenue is recognized when volumes have been physically delivered for the customer through the pipeline.

Income Taxes

We account for income taxes under FASB ASC guidance related to income taxes, which requires recognition of income taxes based on amounts payable with respect to the current year and the effects of deferred taxes for the expected future tax consequences of events that have been included in our financial statements or tax returns. Under this method, deferred tax assets and liabilities are determined based on the differences between the financial accounting and tax basis of assets and liabilities, as well as for operating losses and tax credit carryforwards using enacted tax rates in effect for the year in which the differences are expected to reverse. Valuation allowances are recorded to reduce deferred tax assets when it is more likely than not that a tax benefit will not be realized.

The guidance also prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return, as well as guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosures and transition.

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income prior to the expiration of any net operating loss carryforwards. See "Note (22) Income Taxes" for further details.

Impairment or Disposal of Long-Lived Assets

In accordance with FASB ASC guidance on accounting for the impairment or disposal of long-lived assets, we initiate a review of our long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of a long-lived asset may not be recoverable. Recoverability of an asset is measured by comparison of its carrying amount to the expected future undiscounted cash flows expected to result from the use and eventual disposition of that asset, excluding future interest costs that would be recognized as an expense when incurred. Any impairment to be recognized is measured by the amount by which the carrying amount of the asset exceeds its fair market value. Significant management judgment is required in the forecasting of future operating results that are used

in the preparation of projected cash flows and, should different conditions prevail or judgments be made, material impairment charges could be necessary.

#### Asset Retirement Obligations

FASB ASC guidance related to AROs requires that a liability for the discounted fair value of an asset retirement obligation be recorded in the period in which it is incurred and the corresponding cost capitalized by increasing the carrying amount of the related long-lived asset. The liability is accreted towards its future value each period, and the capitalized cost is depreciated over the useful life of the related asset. If the liability is settled for an amount other than the recorded amount, a gain or loss is recognized.

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(Continued)

Management has concluded that there is no legal or contractual obligation to dismantle or remove the refinery and facilities. Further, management believes that these assets have indeterminate lives under FASB ASC guidance for estimating AROs because dates or ranges of dates upon which we would retire these assets cannot reasonably be estimated at this time. When a date or range of dates can reasonably be estimated for the retirement of these assets, we will estimate the cost of performing the retirement activities and record a liability for the fair value of that cost using present value techniques.

Future asset retirement costs include costs to dismantle, relocate or dispose of our offshore platform, pipeline systems and related onshore facilities, plugging and abandonment of wells and land and sea bed restoration costs. We develop these cost estimates for each of our assets based upon regulatory requirements, platform structure, water depth, reservoir characteristics, reservoir depth, equipment market demand, current procedures and construction and engineering consultations. Because these costs typically extend many years into the future, estimating these future costs are difficult and require management to make judgments that are subject to future revisions based upon numerous factors, including changing technology, political and regulatory environments. We review our assumptions and estimates of future abandonment costs on a quarterly basis.

Derivatives

We are exposed to commodity prices and other market risks including gains and losses on certain financial assets as a result of our refined petroleum products and crude oil inventory risk management policy. Under the refined petroleum products and crude oil inventory risk management policy, Genesis uses commodity futures contracts to mitigate the change in value for a portion of our inventory volumes subject to market price fluctuations. The physical volumes are not exchanged and these contracts are net settled with cash. We recognize all commodity hedge transactions as either current assets or current liabilities in the consolidated balance sheets and those instruments are measured at fair value. Therefore, changes in the fair value of these commodity hedging instruments are included in income in the period of change. Net gains or losses associated with these transactions are recognized within cost of products sold using mark-to-market accounting.

Computation of Earnings Per Share

We apply the provisions of FASB ASC guidance for computing earnings per share (“EPS”). The guidance requires the presentation of basic 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. The guidance requires dual presentation of basic EPS and diluted EPS on the face of the unaudited consolidated statement of operations and requires a reconciliation of the numerators and denominators of basic EPS and diluted EPS. Diluted EPS is computed by dividing net income (loss) available to common stockholders by the diluted weighted average number of common stock outstanding, which includes the potential dilution that could occur if securities or other contracts to issue shares of common stock were converted to common stock that then shared in the earnings of the entity. For periods in which we have a net loss, we exclude stock options because their effect would be anti-dilutive.

The number of shares related to options, warrants, restricted stock and similar instruments included in diluted EPS (“EPS”) is based on the “Treasury Stock Method” prescribed in FASB ASC guidance for computation of EPS. This method assumes theoretical repurchase of shares using proceeds of the respective stock option or warrant exercised, and for restricted stock the amount of compensation cost attributed to future services which has not yet been recognized and the amount of current and deferred tax benefit, if any, that would be credited to additional

paid-in-capital upon the vesting of the restricted stock, at a price equal to the issuer's average stock price during the related earnings period. Accordingly, the number of shares includable in the calculation of EPS in respect of the stock options, warrants, restricted stock and similar instruments is dependent on this average stock price and will increase as the average stock price increases.

#### Stock Based Compensation

In accordance with FASB ASC guidance for stock based compensation, share-based payments to employees, including grants of restricted stock units, are measured at fair value as of the date of grant and are expensed in the consolidated statement of income over the service period (generally the vesting period).

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Treasury Stock

We account for treasury stock under the cost method. When treasury stock is re-issued, the net change in share price subsequent to acquisition of the treasury stock is recognized as a component of additional paid-in-capital in our Condensed Consolidated Balance Sheets.

Business Combinations

We account for acquisitions in accordance with FASB ASC guidance for business combinations. The guidance requires consideration given, including contingent consideration, assets acquired and liabilities assumed to be valued at their fair market values at the acquisition date. The guidance further provides that: (i) in-process research and development be recorded at fair value as an indefinite-lived intangible asset; (ii) acquisition costs generally be expensed as incurred, (iii) restructuring costs associated with a business combination generally be expensed subsequent to the acquisition date; and (iv) changes in deferred tax asset valuation allowances and income tax uncertainties after the acquisition date generally affect income tax expense.

The guidance requires that any excess of purchase price over fair value of assets acquired, including identifiable intangibles and liabilities assumed be recognized as goodwill. Any excess of fair value of acquired net assets, including identifiable intangibles assets, over the acquisition consideration results in a bargain purchase gain. Prior to recording a gain, the acquiring entity must reassess whether all acquired assets and assumed liabilities have been identified and recognized and perform re-measurements to verify that the consideration paid, assets acquired and liabilities assumed have been properly valued.

Reclassification

Certain reclassifications have been made to the prior year's condensed consolidated financial statements in order to conform to the current year's presentation. The most significant of these reclassifications consisted of an increase in cost of refined products sold, and a corresponding decrease in refinery operating expenses.

Recently Adopted Accounting Guidance

In July 2012, FASB amended ASC guidance related to intangibles, goodwill and other. This amendment is intended to reduce the cost and complexity of the annual impairment test for indefinite-lived intangible assets other than goodwill by providing entities an option to perform a qualitative assessment to determine whether further impairment testing is necessary. The amendments are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. We adopted this guidance in 2012. The adoption did not have a material impact on our consolidated financial position, results of operations or cash flows.

New Pronouncements Issued but Not Yet Effective

We have evaluated recent accounting pronouncements that are not yet effective and determined that they do not have a material impact on our consolidated financial statements or disclosures.

(4) LE Acquisition

Effective February 15, 2012, we acquired 100% of the issued and outstanding membership interests of LE from Lazarus Energy Holdings, LLC (“LEH”). The acquisition was considered a business combination. As consideration for LE, we issued, in reliance on the exemption provided by Section 4(2) of the Securities Act of 1933, as amended (the “Securities Act”), 8,393,560 shares of Blue Dolphin common stock, par value \$0.01 per share (the “Common Stock”), subject to anti-dilution adjustments, to LEH (the “Original BDEC Shares”). Additionally, on February 21, 2012, pursuant to anti-dilution provisions, we issued, in reliance on the exemption provided by Section 4(2) of the Securities Act, 32,896 shares of Common Stock to LEH (the “Anti-Dilution Shares” and together with the Original BDEC Shares, the “BDEC Shares”). As a result of the issuance of the BDEC Shares, LEH owns approximately 80% of Blue Dolphin’s issued and outstanding Common Stock. The issuance of the BDEC Shares to LEH resulted in a change in control of Blue Dolphin.

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LE owns the Nixon Facility. The processing plant at the Nixon Facility is currently in a recommissioning phase and has not yet reached its full operational capacity. The tank farm has 120,000 barrels of crude oil storage capacity and 180,000 barrels of refined product storage capacity. The Nixon Facility has the capability to produce products such as Non-Road, Locomotive, and Marine Diesel Fuel (“NRLM”), kerosene, jet fuel and intermediate products such as liquefied petroleum gas, naphtha and atmospheric gas oil.

The acquisition of LE was accounted for as a reverse merger using accounting principles applicable to reverse acquisitions whereby the financial statements subsequent to the date of the transaction are presented as a continuation of LE. Under reverse acquisition accounting, LE (the legal subsidiary) was treated as the accounting parent (acquirer) and Blue Dolphin (the legal parent) was treated as the accounting subsidiary (acquiree). Accordingly, financial statements presented herein reflect the continuation of LE.

The value assigned to the purchase price was allocated to Blue Dolphin’s tangible and intangible assets and liabilities based on their fair values on the transaction effective date (February 15, 2012). LE’s purchase price to acquire Blue Dolphin was based on the fair value of Blue Dolphin’s issued and outstanding Common Stock at February 15, 2012 (2,098,390 shares) multiplied by the closing price of Blue Dolphin’s Common Stock on February 15, 2012 (\$8.60). As a result, the fair value of Blue Dolphin was \$18,046,154.

In connection with the acquisition of LE, we engaged an independent third-party to determine the fair value of the net assets of Blue Dolphin. Fair value of financial and non-financial assets and liabilities is defined as an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants.

The below table summarizes the purchase price allocation of the net assets acquired and measurement period adjustments as of the acquisition date (as adjusted). The estimated fair values of the assets acquired and liabilities assumed were based on information that was available as of the acquisition date. Measurement period adjustments for Blue Dolphin were completed during 2012. Goodwill recognized in the transaction was related to the value expected to be received from the combination of LE’s refinery operations and Blue Dolphin’s pipeline and facilities and operational expertise.

	February 15, 2012 As Initially Reported	Measurement Period Adjustments	Purchase Price Allocation (As Adjusted) February 15, 2012
Current assets	\$2,466,901	\$ -	\$2,466,901
Oil and gas properties	1,503,596	3,639,279	5,142,875
Pipelines	4,466,273	4,757,563	9,223,836
Onshore separation and handling facilities	325,435	-	325,435
Land	473,225	-	473,225
Other property and equipment	282,972	-	282,972
Other long term assets	9,463	-	9,463



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Trade name	184,368	118,978	303,346
Goodwill	8,667,401	(7,221,681 )	1,445,720
Total assets acquired	18,379,634	1,294,139	19,673,773
Current liabilities	333,480	-	333,480
Asset retirement obligations	-	1,294,139	1,294,139
Total liabilities assumed	333,480	1,294,139	1,627,619
Net assets acquired	\$18,046,154	\$ -	\$18,046,154

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## (5) LRM Acquisition

Effective October 1, 2012, we acquired 100% of the issued and outstanding membership interest of LRM, a wholly-owned subsidiary of LEH pursuant to an Assignment Agreement. The acquisition was accounted for as a combination of entities under common control. Accordingly, the recognized assets and liabilities of LRM were transferred at their carrying amounts at the date of transfer and the results of operations are included in our financial results for the three months ended March 31, 2013. LRM did not have significant assets, liabilities or results of operations for the three months ended March 31, 2013. Assets and liabilities included in the consolidated balance sheets were \$30,082 and \$496,716, respectively, as of March 31, 2013. LRM markets petroleum storage and terminaling services at the Nixon Facility.

## (6) Business Segment Information

We are engaged in three lines of business: (i) refinery operations, (ii) pipeline transportation and (iii) oil and gas exploration and production. As part of our refinery operations business segment, we also conduct petroleum storage and terminaling operations. Our primary operating asset is the Nixon Facility. We also operate oil and natural gas pipelines in the Gulf of Mexico and hold oil and natural gas leasehold interests in the U.S. Gulf of Mexico; however, these operations are considered non-core to our business. Management uses earnings before interest, income taxes and depreciation ("EBITDA") to assess the operating results and effectiveness of our business segments.

Segment financials for the three months ended March 31, 2013 (and at March 31, 2013) were as follows:

	Three Months Ended March 31, 2013				Total
	Segment				
	Refinery Operations	Pipeline Transportation	Oil and Gas Exploration & Production	Corporate & Other(1)	
Revenues	\$ 109,171,507	\$ 73,148	\$-	\$-	\$ 109,244,655
Less: Operation cost(2)	(109,063,677)	(96,835 )	(57,664 )	(459,146 )	(109,677,321)
Other non-interest income	278,350	-	-	-	278,350
EBITDA	\$386,180	\$ (23,686 )	\$(57,664 )	\$(459,146 )	
Depletion, depreciation and amortization					(328,788 )
Other income (expense), net					(280,228 )
Loss from continuing operations, before income taxes					\$(763,331 )
Loss from discontinued operations					\$-
Capital expenditures	\$530,226	\$ -	\$-	\$-	\$530,226
Identifiable assets(3)	\$50,131,322	\$ 1,628,612	\$33,773	\$967,906	\$52,761,612

- 
- (1) Includes unallocated general and administrative costs associated with corporate maintenance costs (such as director fees and legal expenses).
  - (2) General and administrative costs are allocated based on revenue. In addition, the effect of economic hedges on our refined petroleum products and crude oil inventory, which are executed by Genesis, is included within the operation cost of our Refinery Operations group. Cost of refined products sold includes a realized loss of \$36,440 and an unrealized gain of \$188,150.
  - (3) Identifiable assets contain related legal obligations of each segment including cash, accounts receivable and payable and recorded net assets.

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Segment financials for the three months ended March 31, 2012 (and at March 31, 2012) were as follows:

	Three Months Ended March 31, 2012				Total
	Segment				
	Refinery Operations	Pipeline Transportation	Oil and Gas & Exploration & Production	Corporate & Other(1)	
Revenues	\$45,770,963	\$ 69,910	\$6,056	\$-	\$45,846,929
Less: Operation cost(2)	(46,862,438)	(195,717 )	(204,287 )	(117,639 )	(47,380,081)
Other non-interest income	93,955	-	-	-	93,955
EBITDA	\$(997,520 )	\$ (125,807 )	\$(198,231 )	\$(117,639 )	
Depletion, depreciation and amortization					(255,753 )
Other income (expense), net					(231,867 )
Loss from continuing operations, before income taxes					\$(1,926,817 )
Loss from discontinued operations					\$(12,514 )
Capital expenditures	\$1,349,332	\$ -	\$-	\$-	\$1,349,332
Identifiable assets(3)	\$56,220,025	\$ 12,567,746	\$5,605,448	\$1,123,919	\$75,517,138

(1) Includes unallocated general and administrative costs associated with corporate maintenance costs (such as director fees and legal expenses).

(2) General and administrative costs are allocated based on revenue.

(3) Identifiable assets contain related legal obligations of each segment including cash, accounts receivable and payable and recorded net assets.

(7) Fair Value Measurement

We are subject to gains or losses on certain financial assets based on our various agreements and understandings with Genesis. Pursuant to these agreements and understandings, Genesis can execute the purchase and sale of certain financial instruments for the purpose of economically hedging certain commodity risks associated with our refined petroleum products and crude oil inventory and, over time, this program may also include mitigating certain risks associated with the purchase of crude oil inputs. These financial instruments are direct contractual obligations of Genesis and not us. However, under our agreements with Genesis, we financially benefit from any gains and financially bear any losses associated with the purchase and/or sale of such financial instruments by Genesis. Because such instruments represent embedded derivatives for the purpose of financial reporting, we account for such embedded derivatives in our books and records by utilizing the market approach when measuring fair value of our financial instruments (typically in current assets and/or liabilities, as discussed below). The market approach uses prices and other relevant information generated by such market transactions executed on our behalf involving identical or comparable assets or liabilities.



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The fair value hierarchy consists of the following three levels:

Level 1 Inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 Inputs are quoted prices for similar assets or liabilities in an active market, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable and market-corroborated inputs, which are derived principally from or corroborated by observable market data.

Level 3 Inputs are derived from valuation techniques in which one or more significant inputs or value drivers are unobservable and cannot be corroborated by market data or other entity-specific inputs.

The carrying amounts of accounts receivable, accounts payable and accrued liabilities approximated their fair values at March 31, 2013 and December 31, 2012 due to their short-term maturities. The fair value of our longer term debt at March 31, 2013 and December 31, 2012 was \$15,743,767 and \$15,806,477, respectively. The following table represents our assets and liabilities measured at fair value on a recurring basis as of March 31, 2013 and the basis for that measurement:

	Carrying Value as at March 31, 2013	Fair Value Measurement at March 31, 2013 Using		
		'Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1)	'Significant Other Observable Inputs (Level 2)	'Significant Unobservable Inputs (Level 3)
Financial liabilities:				
Commodity contracts	\$188,150	\$188,150	\$-	\$ -

Carrying amounts of commodity contracts executed by Genesis are reflected as other current assets or other current liabilities in the condensed consolidated balance sheets.

#### (8) Refined Petroleum Products and Crude Oil Inventory Risk Management

Under our refined petroleum products and crude oil inventory risk management policy, Genesis may, but is not required to, use commodity futures contracts to mitigate the change in value for a portion of our inventory volumes subject to market price fluctuations in our inventory. The physical volumes are not exchanged, and these contracts are net settled by Genesis with cash.

The fair value of these contracts is reflected in the consolidated balance sheets and the related net gain or loss is recorded within cost of refined petroleum products sold in the consolidated statements of operations. Quoted prices for identical assets or liabilities in active markets (Level 1) are considered to determine the fair values for the purpose of marking to market the financial instruments at each period end.

Commodity transactions are executed by Genesis to minimize transaction costs, monitor consolidated net exposures and allow for increased responsiveness to changes in market factors. Genesis may, but is not required to, initiate an economic hedge on our refined petroleum products and crude oil when our inventory levels exceed targeted levels (currently 1.5 days production). Although the decision to enter into a futures contract is made solely by Genesis, Genesis typically confers with management as part of their decision making process.

Due to mark-to-market accounting during the term of the commodity contracts, significant unrealized non-cash net gains and losses could be recorded in our results of operations. Additionally, Genesis may be required to collateralize any mark-to-market losses on outstanding commodity contracts.

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As of March 31, 2013, we had the following obligations based on futures contracts of refined petroleum products and crude oil that were entered into as economic hedges through Genesis. The information presents the notional volume of open commodity instruments by type and year of maturity (volumes in barrels):

Inventory positions (futures):	Notional Contract Volumes by Year of Maturity			
	2013	2014	2015	2016
Refined petroleum products and crude oil - net short (long) positions	50,000	-	-	-

The following table provides the location and fair value amounts of derivative instruments that are reported in the consolidated balance sheets at March 31, 2013 and December 31, 2012:

Liabilities Derivatives	Balance Sheets Location	Fair Value	
		March 31, 2013	December 31, 2012
Commodity contracts	Accrued expenses and other current liabilities	\$ 188,150	\$ 136,100

The following table provides the effect of derivative instruments on the consolidated statements of operations for the three months ended h 31, 2013 and 2012:

Derivatives	Statements of Operations Location	Gain (Loss) Recognized	
		March 31, 2013	March 31, 2012
Commodity contracts	Cost of refined products sold	\$ (188,150 )	\$ -

## (9) Concentration of Risk

**Key Supplier.** GEL TEX Marketing, LLC (“GEL”) is the exclusive supplier of crude oil to the Nixon Facility pursuant to the Crude Supply Agreement, which expires on August 12, 2014.

**Significant Customers.** Customers for our refined petroleum products include distributors, wholesalers and refineries primarily in the lower portion of the Texas Triangle (the Houston - San Antonio - Dallas/Fort Worth area). We have bulk term contracts in place with most of our customers. Many of these arrangements are subject to periodic renegotiation, which could result in us receiving higher or lower relative prices for our refined petroleum products. For the three months ended March 31, 2013, our four largest customers accounted for approximately 81% of our refined petroleum products sales.

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Sales by Product. All of our refined petroleum products were sold in the United States. The following table summarizes the percentages of all refined petroleum products sales to total sales:

	March 31, 2013	%	March 31, 2012	%
Low-sulfur diesel	51.7	%	86.3	%
Naphtha	26.2	%	7.3	%
Atmospheric gas oil	22.1	%	6.4	%
	100.0	%	100.0	%

## (10) Prepaid Expenses and Other Current Assets

Prepaid balances consisted of the following:

	March 31, 2013	December 31, 2012
Prepaid insurance	\$ 138,959	\$ 185,814
Prepaid restructuring fees	50,000	-
Employee advances	-	22,500
Prepaid loan closing fees	20,000	20,000
	\$ 208,959	\$ 228,314

## (11) Deposits

Deposit balances consisted of the following:

	March 31, 2013	December 31, 2012
Utility deposits	\$ 36,500	\$ 36,500
Equipment deposits	124,526	124,526
Tax bonds	792,000	792,000
Purchase option deposits	283,421	283,421
Rent deposits	9,463	-
Deposits	\$ 1,245,910	\$ 1,236,447

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## (12) Inventories

Inventory balances consisted of the following:

	March 31, 2013	December 31, 2012
Low-sulfur diesel	\$ 972,943	\$ 397,240
Naphtha	2,210,804	1,562,055
Atmospheric gas oil	587,004	322,356
Crude	19,041	19,041
	\$ 3,789,792	\$ 2,300,692

## (13) Property, Plant and Equipment, Net

Property and equipment consisted of the following:

	March 31, 2013	December 31, 2012
Refinery and facilities	\$ 34,384,328	\$ 34,000,199
Pipelines and facilities	1,233,811	1,233,811
Onshore separation and handling facilities	325,435	325,435
Land	577,965	577,965
Other property and equipment	629,424	577,567
	37,150,964	36,714,977
Less: Accumulated depletion, depreciation and amortization	2,002,938	1,674,151
	35,148,025	35,040,826
Construction in Progress	915,497	821,259
Property, Plant and Equipment, Net	\$ 36,063,523	\$ 35,862,085

## (14) Discontinued Operations

On November 6, 2012, BDEX entered into a Sale and Purchase Agreement with Blue Sky Langsa, Limited (“Blue Sky”) to dispose of its 7% undivided working interest in Indonesia. The non-cash transaction was completed on February 28, 2013. Operations associated with Indonesia, which were previously reported as part of the Oil and Gas Exploration & Production business segment, have been classified as discontinued operations and are presented in a separate line in the Consolidated Statements of Operations for all periods presented.

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The following is a summary of the operating results of our discontinued operations:

	March 31, 2013	March 31, 2012
Revenue	\$ -	\$ 194,284
Lease operating expenses	-	182,375
Depletion, depreciation and amortization	-	22,209
Accretion expense	-	2,214
Total costs and expenses	-	206,798
Loss from discontinued operations, net of tax	\$ -	\$ (12,514 )

## (15) Accounts Payable, Related Party

LEH, which owns approximately 80% of our Common Stock, manages and operates the Nixon Facility and our other operations (the “Services”) pursuant to a Management Agreement dated February 15, 2012 (the “Management Agreement”).

Under the Management Agreement, LEH receives as compensation for Services, the right to receive (i) weekly payments not to exceed \$750,000 per month, (ii) reimbursement for certain accounting costs related to the preparation of financial statements of LE 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 in excess of 10,000 barrels per day processed at the Nixon Facility during the term of the Management Agreement, 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 GEL dated August 12, 2011 (the “Joint Marketing Agreement”), 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 our Board of Directors (the “Board”) and it may be terminated if the Board determines that the Management Agreement is no longer in our best interests.

Aggregate amounts expensed for Services at the Nixon Facility for the three months ended March 31, 2013 and March 31, 2012 were \$2,745,209 (approximately \$2.80 per barrel) and \$1,062,751 (approximately \$2.72 per barrel). At March 31, 2013 and December 31, 2012, the amounts outstanding to LEH were \$2,178,061 and \$1,594,021, respectively, and are reflected in accounts payable, related party in the condensed consolidated balance sheets.

Herbert N. Whitney, a member of our Board, currently serves as a consultant to LEH. Jonathan P. Carroll, our Chief Executive Officer, President, Assistant Treasurer and Secretary, is also a member of LEH. Tommy L. Byrd, our interim Chief Financial Officer, Treasurer and Assistant Secretary, is also an employee of LEH.



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(16) Notes Payable

Notes payable at March 31, 2013 and December 31, 2012 was \$9,348,518 and \$43,941, respectively. The Refinery Loan portion of notes payable at March 31, 2013 and December 31, 2012 was \$9,298,183 and \$0, respectively.

Refinery Loan. In September 2008, LE obtained a loan from First International Bank (“FIB”) in the amount of \$10,000,000 (the “Refinery Loan”). The Refinery Loan accrues interest at a rate of prime plus 2.25% (effective rate of 5.50% at March 31, 2013) and has a maturity date of October 2028. The Refinery Loan is: (i) secured by a first lien on the Nixon Facility and general assets of LE and (ii) subject to certain restrictive financial covenants related to debt to net worth and current ratio. Currently, we are not in compliance with certain financial covenants and, since August 2011, the Refinery Loan has been subject to a forbearance agreement (the “Forbearance Agreement”). Interest was accrued on the Refinery Loan in the amount of \$178,646 and \$250,070 at March 31, 2013 and December 31, 2012, respectively.

The Forbearance Agreement provides for a reduced minimum monthly payment on the Refinery Loan of \$60,000. The initial forbearance period under the Forbearance Agreement commenced in August 2011 and ended in August 2012 (the “Initial Forbearance Period”) with an additional one year extension period beyond the Initial Forbearance Period ending on August 12, 2013 (the “Extended Forbearance Period” and together with the Initial Forbearance Period, the “Forbearance Period”), if we satisfied certain conditions. In October 2011, the Refinery Loan and its related security documents (the “Refinery Loan Documents”) were acquired by American First National Bank (“AFNB”). In June 2012, AFNB sent a letter to LE outlining what AFNB believed to be contraventions to certain provisions of the Refinery Loan, the Refinery Loan Documents and the Forbearance Agreement, including an assertion that Blue Dolphin’s acquisition of LE represented a change of control of LE, resulting in a default under the Refinery Loan. We responded to AFNB expressing a belief that LE was in compliance with provisions of the Refinery Loan Documents. In December 2012, AFNB sent a letter to LE confirming that LE was in compliance with the provisions of the Refinery Loan Documents, and providing for an extension of the Forbearance Agreement through the Extended Forbearance Period.

During the Forbearance Period, we remain subject to the terms, conditions and covenants of the Refinery Loan, other than those that our compliance with is expressly waived by the Forbearance Agreement. Further, AFNB may terminate the Forbearance Agreement and any extensions thereof at any time if any of the following events (the “Termination Events”) occur:

We do not, upon the Nixon Facility becoming operational, and the cessation of the payment of tank storage fees by Genesis to us, make the required minimum monthly payment to AFNB;

There is a default under the Refinery Loan (other than the existing default) that is not cured within 30 days subject to certain extensions;

There is a default under the Forbearance Agreement, the Construction and Funding Agreement, the Joint Marketing Agreement or the Crude Oil Supply and Throughput Services Agreement between LE and GEL dated August 12, 2011 (the “Crude Supply Agreement”) and such default continues for 10 days after its occurrence; or

LE files for bankruptcy protection or takes part in any other insolvency proceeding, seeks relief under any debtor relief law or has a receiver or similar official appointed.

As of the date of filing of this report, no Termination Events have occurred.

After all past due principal and interest (as well as costs, fees and taxes) have been paid, AFNB will: (i) re-amortize the Refinery Loan to the original maturity date of October 1, 2028 and (ii) apply twelve consecutive additional monthly payments in the amount of \$83,333.33 towards replenishing the \$1,000,000 payment reserve required under the Refinery Loan in accordance with the Forbearance Agreement.

Short-Term Note for Financing Costs. The balance on a short-term note issued in January 2010 in the amount of \$100,000 as payment for financing costs was \$34,866 and \$39,866 at March 31, 2013 and December 31, 2012, respectively. The unsecured note, which bears interest at 18% and was originally due in January 2012, has been extended to June 2013.

Short-Term Capital Leases. The balance on short-term notes under capital lease agreements was \$15,469 and \$0 at March 31, 2013 and December 31, 2012, respectively. In January 2013 we acquired a pressure washer under an interest-free, short-term capital lease. We also reclassified capital leases from long-term debt at December 31, 2012 to short-term debt at March 31, 2013 as they mature at various dates through February 2014. These capital leases have interest rates ranging from 0% to 13.04%. The assets and liabilities under capital leases are recorded at the lower of the present value of the minimum lease payments or the fair value of the assets. The assets are amortized over the lower of their related lease terms or their estimated productive lives.

The balance on a short-term note related to previously owned trucks for use at the Nixon Facility was \$0 and \$4,075 at March 31, 2013 and December 31, 2012, respectively. The unsecured note bore interest at 5%.

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## (17) Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities consisted of the following:

	March 31, 2013	December 31, 2012
Excise taxes	\$ 254,549	\$ 292,303
Salaries	109,717	134,501
Turnaround expenses	141,406	-
Transportation	-	69,551
Other payable	37,605	-
Property taxes	13,500	-
Insurance	57,492	-
Unrealized hedging loss	188,150	136,100
Unearned revenue	92,783	92,783
	\$ 895,202	\$ 725,238

## (18) Asset Retirement Obligations

## Refinery and Facilities

Management has concluded that there is no legal or contractual obligation to dismantle or remove our refinery and facilities assets. Management believes that our refinery and facilities assets have indeterminate lives under FASB ASC guidance for estimating AROs because dates or ranges of dates upon which we would retire these assets cannot reasonably be estimated at this time. When a date or range of dates can reasonably be estimated for the retirement of these assets, we will estimate the cost of performing the retirement activities and record a liability for the fair value of that cost using present value techniques.

## Oil and Gas Properties and Pipelines and Facilities Assets

We have AROs associated with the future abandonment, dismantlement and removal of our oil and gas properties, as well as our pipelines and facilities assets, as follows:

Asset retirement obligations as of December 31, 2012	\$921,260
Accretion expense	25,164
	946,424
Less: current portion of asset retirement obligations	90,601
Asset retirement obligations, long-term balance at March 31, 2013	\$855,823

Actual plugging and abandonment expenses associated with HI-A7 have exceeded the estimated ARO liability. Additional plugging and abandonment expenses associated with HI-A7 will be recognized as a loss in the period incurred. For the three months ended March 31, 2013, we recognized \$27,451 in abandonment expense for AROs associated with HI-A7. We will record additional plugging and abandonment costs for HI-A7 as information becomes available from the operator, Apache Corp., to substantiate actual and/or probable costs.



## (19) Long-Term Debt

Our long-term debt consists of notes payable, construction financing and capital leases, as follows:

	March 31, 2013	December 31, 2012
Refinery Loan	\$ -	\$ 9,298,183
Notre Dame Debt	1,300,000	1,300,000
Construction Funding	5,145,584	5,206,175
Capital Leases	-	2,119
	6,445,584	15,806,477
Less: Current portion of long-term debt	1,485,000	1,816,960
	\$ 4,960,584	\$ 13,989,517

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Notre Dame Debt. LE obtained a loan in the original amount of \$8,000,000 from Notre Dame Investors, Inc., which is currently held by John Kissick (the “Notre Dame Debt”). The Notre Dame Debt, which is currently in default, accrues interest at the default rate of 16% and is secured by a subordinated lien on the Nixon Facility and general assets of LE. Interest was accrued on the note in the amount of \$910,071 and \$858,784 at March 31, 2013 and December 31, 2012, respectively. There are no financial covenants associated with the Notre Dame Debt.

In August 2011, LE, Milam and John Kissick, entered into an intercreditor and subordination agreement under which Mr. Kissick, as a subordinated lien holder on the Nixon Facility, agreed to (i) subordinate his lien to the liens of Milam under the Construction and Funding Agreement and (ii) forebear his rights under the note evidencing the Notre Dame Debt for so long as amounts are outstanding on the Refinery Loan and any senior construction funding obligations. Furthermore, in August 2011, Mr. Kissick confirmed, acknowledged and agreed not to institute a suit or other proceeding against LE to foreclose upon any liens that have been established pursuant to the Notre Dame Debt or exercise any other rights or remedies pursuant to the promissory note evidencing the Notre Dame Debt under applicable law or otherwise so long as the Joint Marketing Agreement, which expires in August 2014, is in effect and has not been terminated.

Construction and Funding Agreement. In August 2011, Milam committed funding for the completion of the Nixon Facility’s refurbishment and start-up operations. We started making payments under the Construction and Funding Agreement in the first quarter of 2012. All amounts advanced under the Construction and Funding Agreement bear interest at a rate of 6% annually. Interest was accrued on the Construction and Funding Agreement in the amount of \$457,568 and \$386,695 at March 31, 2013 and December 31, 2012, respectively. There are no financial covenants associated with this obligation.

See “Note (23) Commitments and Contingencies” of this report for additional disclosures related to amendments to the Joint Marketing Agreement, which previously added to our obligation amount under the Construction and Funding Agreement.

Capital Leases. LE was obligated under various capital lease agreements for equipment totaling \$2,119 at December 31, 2012. As the capital leases mature at various dates through February 2014, capital lease obligations totaling \$1,835 were reclassified to short-term notes payable at March 31, 2013.

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(20) Leases

We are currently under a ten-year lease agreement that expires in 2017 for office space in downtown Houston, Texas. The Houston office serves as our company headquarters. The current minimum monthly payment is \$9,463 per month. The office lease agreement provides for periodic rent escalations or rent holidays over the term of the lease, which is recognized on a straight-line basis. Rent expense for the office lease was \$29,041 and \$28,344 for the three months ended March 31, 2013 and 2012, respectively.

(21)