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BLUE DOLPHIN ENERGY CO
Form 10-Q
August 21, 2001

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

FORM 10-Q

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

For the period ended: June 30, 2001

or

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

For the transition period from _____ to _____

Commission File 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, Suite 2100, Houston, Texas 77002
(Address of principal executive offices) (Zip Code)

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES X NO
--- ---

APPLICABLE ONLY TO CORPORATE ISSUERS:

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

6,020,051 shares of the Registrants' common stock, par value \$.01 per share,

where outstanding at August 14, 2001.

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

The condensed consolidated financial statements of Blue Dolphin Energy Company and subsidiaries (the "Company") included herein have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission and, in the opinion of management, reflect all adjustments necessary to present a fair statement of operations, financial position and cash flows. The Company follows 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. The Company believes 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 generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations.

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

| | June 30, 2001 | December 31, 2000 |
|--|------------------|----------------------|
| | ----- | ----- |
| | (Unaudited) | |
| ASSETS | | |
| Current Assets: | | |
| Cash | \$ 3,753,378 | \$ 2,071,682 |
| Trade accounts receivable | 1,377,477 | 2,406,751 |
| Funds escrowed for abandonment | 68,629 | 1,485,728 |
| Prepaid expenses | 297,395 | 127,913 |
| | ----- | ----- |
| TOTAL CURRENT ASSETS | 5,496,879 | 6,092,074 |
| Property and Equipment, at cost: | | |
| Oil and Gas properties, including \$430,782 of unproved leasehold cost at June 30, 2001 and December 31, 2000, respectively (full-cost method) | 28,224,430 | 28,032,211 |
| Onshore separation and handling facilities | 1,583,428 | 1,583,610 |

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| | | |
|---|---------------|---------------|
| Land | 850,000 | 930,500 |
| Pipelines | 2,771,142 | 4,845,975 |
| Other property and equipment | 734,657 | 397,683 |
| | ----- | ----- |
| | 34,163,657 | 35,789,979 |
| Accumulated depletion, depreciation and amortization | (30,376,970) | (30,444,622) |
| | ----- | ----- |
| | 3,786,687 | 5,345,357 |
| Deferred federal income tax | 244,444 | 244,444 |
| Acquisition and development costs - Petroport | 1,934,729 | 1,885,219 |
| Other assets | 628,104 | 345,861 |
| | ----- | ----- |
| TOTAL ASSETS | \$ 12,090,843 | \$ 13,912,955 |
| | ===== | ===== |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current Liabilities: | | |
| Trade accounts payable | \$ 975,043 | \$ 1,557,850 |
| Current portion of long term debt | -- | 218,412 |
| Notes payable - related parties | 100,000 | 2,000,000 |
| Accrued expenses and other liabilities | 1,863,679 | 927,347 |
| | ----- | ----- |
| TOTAL CURRENT LIABILITIES | 2,938,722 | 4,703,609 |
| Other non-current liabilities | -- | 550,000 |
| Minority interests | 1,212,399 | 1,196,479 |
| Common Stock | 60,201 | 60,167 |
| Additional Paid-in Capital | 25,768,727 | 25,775,417 |
| Accumulated Deficit | (17,889,206) | (18,372,717) |
| | ----- | ----- |
| TOTAL LIABILITES AND STOCKHOLDERS EQUITY | \$ 12,090,843 | \$ 13,912,955 |
| | ===== | ===== |

See accompanying notes to consolidated financial statements.

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS - UNAUDITED

| | Three Months Ended June 30, | |
|--------------------------|--------------------------------|--------------|
| | 2001 | 2000 |
| | ----- | ----- |
| Revenue from operations: | | |
| Oil and gas sales | \$ 1,462,015 | \$ 1,141,506 |
| Pipeline operations | 231,878 | 588,236 |

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| | | |
|---|-------------|------------|
| Operating fees | -- | 78,188 |
| | ----- | ----- |
| REVENUE FROM OPERATIONS | 1,693,893 | 1,807,930 |
| Cost of operations: | | |
| Lease operating expenses | 293,626 | 314,876 |
| Pipeline operating expenses | 118,210 | 265,252 |
| Depletion, depreciation, amortization and abandonment | 424,646 | 454,502 |
| General and administrative | 777,661 | 572,198 |
| | ----- | ----- |
| COST OF OPERATIONS | 1,614,143 | 1,606,828 |
| | ----- | ----- |
| INCOME FROM OPERATIONS | 79,750 | 201,102 |
| Other income (expense): | | |
| Interest and other expense | (164,402) | (32,586) |
| Interest and other income | 44,352 | 18,042 |
| | ----- | ----- |
| INCOME (LOSS) BEFORE MINORITY INTEREST AND INCOME TAXES | (40,300) | 186,558 |
| Minority interests | (29,106) | (35,861) |
| Provision for income taxes | -- | -- |
| | ----- | ----- |
| Net income (loss) | \$ (69,406) | \$ 150,697 |
| | ===== | ===== |
| Earnings (loss) per share-basic | \$ (0.01) | \$ 0.03 |
| | ===== | ===== |
| Earnings (loss) per share-diluted | \$ (0.01) | \$ 0.03 |
| | ===== | ===== |
| Weighted average number of common shares outstanding and potential dilutive common shares: | | |
| Basic | 6,020,051 | 5,951,436 |
| | ===== | ===== |
| Diluted | 6,020,051 | 6,002,072 |
| | ===== | ===== |

See accompanying notes to consolidated financial statements.

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| | 2001 | 2000 |
|---|--------------|--------------|
| | ----- | ----- |
| Revenue from operations: | | |
| Oil and gas sales | \$ 3,252,867 | \$ 2,177,215 |
| Pipeline operations | 554,076 | 1,059,082 |
| Operating fees | -- | 156,414 |
| | ----- | ----- |
| REVENUE FROM OPERATIONS | 3,806,943 | 3,392,711 |
| Cost of operations: | | |
| Lease operating expenses | 627,390 | 598,463 |
| Pipeline operating expenses | 268,948 | 506,245 |
| Gain on sale of assets | (1,417,626) | -- |
| Depletion, depreciation, amortization and abandonment | 2,002,808 | 910,772 |
| General and administrative | 1,596,164 | 1,070,733 |
| | ----- | ----- |
| COST OF OPERATIONS | 3,077,684 | 3,086,213 |
| | ----- | ----- |
| INCOME FROM OPERATIONS | 729,259 | 306,498 |
| Other income (expense): | | |
| Interest and other expense | (329,642) | (56,481) |
| Interest and other income | 97,473 | 21,164 |
| | ----- | ----- |
| INCOME BEFORE MINORITY INTEREST AND INCOME TAXES | 497,090 | 271,181 |
| Minority interests | (13,582) | (67,647) |
| Provision for income taxes | -- | -- |
| | ----- | ----- |
| Net income | \$ 483,508 | \$ 203,534 |
| | ===== | ===== |
| Earnings per common share-basic | \$ 0.08 | \$ 0.03 |
| | ===== | ===== |
| Earnings per common share-diluted | \$ 0.08 | \$ 0.03 |
| | ===== | ===== |
| Weighted average number of common shares outstanding and potential dilutive common shares: | | |
| Basic | 6,018,440 | 5,951,158 |
| | ----- | ----- |
| Diluted | 6,037,458 | 6,001,794 |
| | ===== | ===== |

See accompanying notes to consolidated financial statements.

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BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS - UNAUDITED

| | | Six Months Ended June 2001 |
|---|----|----------------------------------|
| | | ----- |
| OPERATING ACTIVITIES | | |
| Net income | \$ | 483,508 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depletion, depreciation, amortization and abandonment | | 2,002,808 |
| Minority interest | | 13,582 |
| Gain on sale of assets | | (1,417,626) |
| Changes in operating assets and liabilities: | | |
| (Increase) decrease in trade accounts receivable | | 957,069 |
| (Increase) in prepaid expenses | | (169,482) |
| Abandonment costs incurred | | (1,473,960) |
| Increase in accounts payable and other current liabilities | | 51,013 |
| | | ----- |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | | 446,912 |
| INVESTING ACTIVITIES | | |
| Oil and gas prospect generation costs | | -- |
| Reimbursement of oil and gas prospect generation costs | | -- |
| Purchases of property and equipment | | (1,602,571) |
| Exploration and development costs | | (387,000) |
| Net proceeds from sale of assets | | 4,625,000 |
| Funds escrowed for abandonment costs | | (34,347) |
| Release of escrowed funds for abandonment | | 1,451,446 |
| Development costs - Petroport | | (49,510) |
| Development costs - New Avoca | | (158,497) |
| Acquisition of additional interest in Drillmar, net of cash acquired | | (270,529) |
| Increase in other assets | | (214,140) |
| | | ----- |
| NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES | | 3,359,852 |
| FINANCING ACTIVITIES | | |
| Net proceeds from borrowings | | 100,000 |
| Payments on borrowings | | (2,218,412) |
| Other | | (6,656) |
| | | ----- |
| NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES | | (2,125,068) |
| INCREASE IN CASH | | 1,681,696 |
| CASH AT BEGINNING OF PERIOD | | 2,071,682 |
| | | ----- |
| CASH AT JUNE 30 | \$ | 3,753,378 |
| | | ===== |

SUPPLEMENTARY CASH FLOW INFORMATION

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| | | |
|-------------------|-----------|----|
| Interest paid | \$ 98,500 | \$ |
| | ===== | = |
| Income taxes paid | \$ 6,530 | \$ |
| | ===== | = |

See accompanying notes to consolidated financial statements.

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BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

FOOTNOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS UNAUDITED

June 30, 2001

1. Related Party Transactions

In December 1999, the Company issued a \$1,000,000 convertible promissory note to Harris A. Kaffie, a director of the Company. This convertible promissory note originally due June 1, 2000 was extended to March 31, 2001, bore interest at 10% per annum, and was convertible into common stock at \$6.00 per share. This convertible promissory note and accrued interest of \$64,361 were paid in January 2001.

The Company issued three convertible promissory notes in 2000 totaling \$1,000,000; two in the principal amount of \$200,000 each on May 25, 2000 and July 6, 2000, issued to Ivar Siem, Chairman of the Company, and one in the principal amount of \$600,000 on November 30, 2000, issued to TI A/S, beneficially controlled by Ivar Siem. These convertible promissory notes and accrued interest of \$32,790 were paid in January 2001. The convertible promissory notes were due March 31, 2001, bore interest at the rate of 10% per annum and were convertible into common stock at the rate of \$6.00 per share.

At June 30, 2001, Ivar Siem provided Drillmar \$100,000 and was issued an unsecured promissory note due December 31, 2001, bearing interest at 10% per annum. In July 2001, Drillmar was provided \$300,000 from Ivar Siem and \$200,000 from Harris Kaffie and were issued unsecured promissory notes due December 31, 2001, bearing interest at 10% per annum. The promissory note due to Harris Kaffie was paid on August 7, 2001. Accrued interest of \$986 was also paid to Mr. Kaffie in August 2001. The promissory notes issued by Drillmar are non recourse to the Company.

2. Contingencies

In December 1999, American Resources Offshore, Inc. ("American Resources") received approximately \$4.5 million from Blue Dolphin Exploration Company for American Resources common stock representing a 75% ownership interest, and \$24.2 million from Fidelity Oil Holdings, Inc. ("Fidelity Oil") for an 80% interest in its Gulf of Mexico assets. American Resources senior secured debt was held by Den norske Bank ("Den norske"). Den norske sold the senior debt to the Company for the right to receive a possible future payment if the cumulative net revenues received by American Resources and Fidelity Oil attributable to American Resources proved oil and gas reserves in the Gulf of Mexico as of January 1, 1999, exceed \$30.0 million during the period January 1, 1999 through December 31, 2001. If that occurs, Den norske will be entitled to receive an

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amount equal to 50% of the net revenues in excess of \$30.0 million during that three-year period. If any contingent amount becomes payable to Den norske, 80% will be paid by Fidelity Oil and 20% will be paid by American Resources. The payment, if any, is due on March 15, 2002. American Resources estimates that it is probable that a payment to Den norske will be due based upon these terms and current market conditions. The Company has provided for a liability to Den norske in the amount of \$850,000 at June 30, 2001.

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BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

FOOTNOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

UNAUDITED

(Continued)

On May 8, 2000, American Resources, a 77% indirectly owned subsidiary of the Company, and its former Chief Financial Officer, were named in a lawsuit in the United States District Court for the Southern District of Texas, Houston Division, styled H&N Gas and Howard Energy Marketing, L.L.C. v. American Resources Offshore, Inc. et al (Case No H-00-1371). The lawsuit alleges, among other things, that H&N Gas ("H&N") was defrauded by American Resources in connection with gas purchase options and gas price swap contracts entered into from February 1998 through September 1999. H&N alleges unlawful collusion between American Resources' prior management and the then president of H&N, Richard Hale ("Hale"), to the detriment of H&N. H&N generally alleges that Hale directed H&N to purchase illusory options from American Resources that bore no relation to any physical gas business and that American Resources did not have the financial resources and/or sufficient quantity of gas to perform. H&N further alleges that American Resources and Hale colluded with respect to swap transactions that were designed to benefit American Resources at the expense of H&N Gas. H&N further alleges civil conspiracy against all the defendants. H&N is seeking approximately \$6.2 million in actual damages plus treble damages, punitive damages, prejudgment interest and attorneys' fees against American Resources directly. As a result of its conspiracy allegation, H&N also contends that all defendants are jointly and severally liable for over \$62.0 million dollars in actual damages plus treble damages, punitive damages, prejudgment interest and attorneys' fees. American Resources intends to vigorously defend this claim.

As a result of the decision to cease operating activities in the Buccaneer Field, the Company's leases in or on the Buccaneer Field terminated in January 2001. The Company must plug and abandon all remaining wells and remove platform facilities within one year from the termination of the leases. In the first quarter of 2001, the Company plugged and abandoned its remaining wells at a cost of approximately \$1.4 million. Removal of the platform facilities is expected to take place in the second half of 2001 at an additional cost estimated to be \$5.1 million. The Company increased its estimate of the cost of abandonment of the Buccaneer Field by approximately \$1.1 million from December 31, 2000. The Company used \$1.4 million of funds escrowed to pay for well plugging and abandonment costs.

The Company is involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material effect on the Company's financial position, results of operations or cash flows.

3. Acquisition of Drillmar Inc.

Effective May 1, 2001 the Company increased its ownership in Drillmar Inc.

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("Drillmar") from 37.5% to 64%. Consideration paid by the Company includes cash of approximately \$131,000, a contribution of services in the amount of \$298,000, and an undertaking to contribute an additional \$136,000 of cash and/or services. The Company's consolidated income for the six months ended June 30, 2001 includes 37.5% of Drillmar's operations for the four months ended April 30, 2001 and 64% of Drillmar's operations for the two months ended June 30, 2001.

Certain amounts in the six month consolidated statements of operations and cash flows have been reclassified to reflect the consolidation of Drillmar effective January 1, 2001.

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BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

FOOTNOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS UNAUDITED (Continued)

4. Earnings Per Share

The Company applies the provisions of Statement of Financial Accounting Standards No. 128 ("SFAS No. 128"), "Earnings per Share." SFAS No. 128 requires the presentation of basic earnings per share ("EPS") which excludes dilution and is computed by dividing income available to common stockholders by the weighted-average number of shares of common stock outstanding for the period. SFAS No. 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.

The following table provides a reconciliation between basic and diluted earnings per share:

| | Net Income (Loss) | Weighted average common shares outstanding and dilutive potential common shares | Per share amount |
|-------------------------------------|----------------------|---|------------------------|
| | ----- | ----- | ----- |
| Six Months ended June 30, 2001 | | | |
| Basic earnings per share | \$ 483,508 | 6,018,440 | \$ 0.08 |
| Effect of dilutive stock options | | 19,018 | |
| | ----- | ----- | ----- |
| Diluted earnings per share | \$ 483,508 | 6,037,458 | \$ 0.08 |
| | ===== | ===== | ===== |
| Six Months ended June 30, 2000 | | | |
| Basic earnings per share | \$ 203,534 | 5,951,158 | \$ 0.03 |
| Effect of dilutive stock options | | 50,636 | |
| | ----- | ----- | ----- |
| Diluted earnings per share | \$ 203,534 | 6,001,794 | \$ 0.03 |
| | ===== | ===== | ===== |
| Quarter ended June 30, 2001 | | | |
| Basic earnings (loss) per share | \$ (69,406) | 6,021,051 | \$ (0.01) |

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| | | | |
|-----------------------------------|-------------|-----------|-----------|
| | ----- | ----- | ----- |
| Diluted earnings (loss) per share | \$ (69,406) | 6,021,051 | \$ (0.01) |
| | ===== | ===== | ===== |
| | | | |
| Quarter ended June 30, 2000 | | | |
| Basic earnings per share | \$ 150,697 | 5,951,436 | \$ 0.03 |
| Effect of dilutive stock options | | 50,636 | |
| | ----- | ----- | ----- |
| Diluted earnings per share | \$ 150,697 | 6,002,072 | \$ 0.03 |
| | ===== | ===== | ===== |

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BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

FOOTNOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS UNAUDITED (Continued)

5. Recently Issued Accounting Pronouncements

Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"), was issued in June 1998 by the Financial Accounting Standards Board. SFAS 133 establishes new accounting and reporting standards for derivative instruments and for hedging activities. This statement requires an entity to establish at the inception of a hedge, the method it will use for assessing the effectiveness of the hedging derivative and the measurement approach for determining the ineffective aspect of the hedge. Those methods must be consistent with the entity's approach to managing risk. Certain provisions of SFAS 133 were amended by SFAS 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities - an amendment of Statement 133". SFAS 133, as amended, is effective for all fiscal quarters of fiscal years beginning after June 15, 2000. The Company adopted SFAS 133 effective January 1, 2001. Adoption of SFAS 133, as amended, did not have an impact on the Company's consolidated financial position or the results of operations.

In July 2001, the Financial Accounting Standards Board issued Statement No. 141 ("SFAS 141"), "Business Combinations," and Statement No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"). SFAS 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. SFAS 141 also specifies criteria intangible assets acquired in a purchase method business combination must meet to be recognized and reported apart from goodwill. SFAS 142 will require that goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead tested for impairment at least annually in accordance with the provisions of SFAS 142. SFAS 142 will also require that intangible assets with definite useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with SFAS 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of. As of the date of adoption, the Company does not expect to have unamortized goodwill, unamortized identifiable assets, or unamortized negative goodwill.

In August 2001, the Financial Accounting Standards Board approved Statement No. 143 ("SFAS 143") "Asset Retirement Obligations". The Company has not assessed the impact of SFAS 143 at this time.

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6. Sale of Assets

On January 22, 2001, the Company sold its 50% interest in the Black Marlin Pipeline System to affiliates of the Williams Companies, Inc. for approximately \$4.6 million. The Black Marlin Pipeline System includes a 75-mile gas and condensate gathering line with related shore facilities servicing the High Island Area, offshore Texas (the "Black Marlin Pipeline") and the 3-mile lateral pipeline constructed in 2000, extending from High Island Block A-5 to an interconnection into the Black Marlin Pipeline in High Island Block A-6 (the "A-5 Lateral").

This disposition was consummated, in part, through a sale of all of the outstanding capital stock of Black Marlin Pipeline Company (formerly an indirect wholly owned subsidiary of the Company) the owner of a 50% interest in the Black Marlin Pipeline, pursuant to a Purchase and Sale Agreement dated January 12, 2001 (the "Stock Purchase Agreement") among Black Marlin Energy Company, a wholly owned subsidiary of the Company, MCNIC Offshore Pipeline & Processing Company ("MCNIC"), WBI Southern, Inc. ("WBI") and Williams Field Services Group, Inc. The Company received \$3.6 million for the outstanding capital stock of Black Marlin Pipeline Company and recorded a gain of \$1,305,534.

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BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

FOOTNOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
UNAUDITED
(Continued)

The remaining part of this disposition was consummated through the sale of the A-5 Lateral owned 50% by Blue Dolphin Pipe Line Company, a wholly owned subsidiary of the Company ("BDPL"), pursuant to a Purchase and Sale Agreement dated January 12, 2001, among BDPL, MCNIC, WBI and Williams Field Services - Gulf Coast Company, L.P. The Company received \$1.0 million for its interest in the A-5 Lateral, and recorded a gain of \$112,092.

7. Business Segment Information

The Company's income producing operations are conducted in two principal business segments: oil and gas exploration and production, and pipeline operations. Intersegment revenues consist of transportation, general processing and storage fees charged by certain subsidiaries to another for natural gas and crude oil transported through the Blue Dolphin Pipeline System. The intercompany revenues and expenses are eliminated in consolidation. Information concerning these segments for the six months and three months ended June 30, 2001, and 2000, and at June 30, 2001 and December 31, 2000 is as follow:

| | Revenues | Intersegment revenues | Opera inc (loss |
|---------------------------------|----------|--------------------------|-----------------------|
| | ----- | ----- | ----- |
| Six months ended June 30, 2001: | | | |
| Oil and gas exploration and | | | |

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| | | | |
|---|--------------|--------|-------|
| production and operating fees | \$ 3,252,867 | -- | (1) |
| Pipeline operations | 554,076 | -- | 1,4 |
| Other | -- | | (5) |
| | ----- | | ----- |
| Consolidated | 3,806,943 | -- | 7 |
| Other income | | | (2) |
| | | | ----- |
| Income before minority interest and income taxes | | | 4 |
| Six months ended June 30, 2000: | | | |
| Oil and gas exploration and production and operating fees | \$ 2,336,629 | 3,000 | 8 |
| Pipeline operations | 1,070,337 | 11,255 | 3 |
| Other | (14,255) | | (8) |
| | ----- | | ----- |
| Consolidated | 3,392,711 | -- | 3 |
| Other expense | | | (|
| | | | ----- |
| Income before minority interest and income taxes | | | 2 |

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BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

FOOTNOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
UNAUDITED
(Continued)

| | Revenues | Intersegment revenues | Opera inc (loss) |
|---|--------------|-----------------------|------------------|
| | ----- | ----- | ----- |
| Three months ended June 30, 2001: | | | |
| Oil and gas exploration and production and operating fees | \$ 1,462,015 | -- | 3 |
| Pipeline operations | 231,878 | -- | (2) |
| Other | -- | | |
| | ----- | | ----- |
| Consolidated | 1,693,893 | -- | (1) |
| Other expense | | | (|
| | | | ----- |
| Loss before minority interest and income taxes | | | (|
| Three months ended June 30, 2000: | | | |
| Oil and gas exploration and production and operating fees | \$ 1,221,194 | 1,500 | 4 |
| Pipeline operations | 593,006 | 4,770 | 1 |
| Other | (6,270) | | (4) |
| | ----- | | ----- |
| Consolidated | 1,807,930 | -- | 2 |
| Other expense | | | (|

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Income before minority interest and income taxes

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| | June 30, 2001 | December 31, 2000 |
|---|------------------|----------------------|
| | ----- | ----- |
| Identifiable assets: | | |
| Oil and gas exploration and production | \$ 3,993,445 | \$ 4,164,299 |
| Pipeline operations | 6,870,778 | 8,958,876 |
| Other | 1,226,620 | 789,780 |
| | ----- | ----- |
| Consolidated | 12,090,843 | 13,912,955 |

1. Consolidated income from operations includes \$547,780 and \$801,445 in unallocated general and administrative expenses, and unallocated depletion, depreciation and amortization of \$15,322 and \$14,664 for the six months ended June 30, 2001 and 2000, respectively.

Consolidated income from operations includes \$290,587 and \$403,792 in unallocated general and administrative expenses, and unallocated depletion, depreciation and amortization of \$4,259 and \$7,662 for the quarters ended June 30, 2001 and 2000, respectively.

2. Pipeline depletion, depreciation and amortization includes a provision for pipeline abandonment of \$9,870 and \$9,870 for the six months ended June 30, 2001 and 2000, respectively. Oil and gas depletion, depreciation, amortization and abandonment includes a provision for abandonment costs of platforms and wells of \$11,925 for the six months ended June 30, 2000. In addition, the Company recorded an expense of approximately \$1,100,000 for the six months ended June 30, 2001, as a result of a change in the estimation of costs associated with the Buccaneer Field abandonment.

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3. Pipeline depletion, depreciation and amortization includes a provision for pipeline abandonment of \$4,935 and \$4,935 for the quarters ended June 30, 2001 and 2000, respectively. Oil and gas depletion, depreciation, amortization and abandonment includes a provision for abandonment costs of platforms and wells of \$5,430 for the quarter ended June 30, 2000.

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BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL

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CONDITION AND RESULTS OF OPERATIONS - CONTINUED

CAUTIONARY NOTE REGARDING FORWARD LOOKING STATEMENTS

Certain of the statements included below, 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. 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" or the "Company") cautions readers that any such 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 that could cause actual results to vary from forward-looking statements are discussed in our Registration Statement on Form S-3 filed with the Securities and Exchange Commission on January 11, 2001 under the caption "Risk Factors". The Risk Factors section of this Registration Statement is incorporated by reference into this report. Readers are cautioned not to place undue reliance on these forward-looking statements which speak only as of the date hereof. The Company undertakes no duty to update these forward-looking statements. Readers are urged to carefully review and consider the various disclosures made by the Company which attempt to advise interested parties of the additional factors which may affect the Company's business, including the disclosures made under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations" in this report.

The following is a review of certain aspects of the financial condition and results of operations of the Company and should be read in conjunction with the Condensed Consolidated Financial Statements included in Item 1. of this report.

RECENT DEVELOPMENTS

The Company previously announced a gas discovery in High Island Area Block A-7, in the Gulf of Mexico. The Company acquired the block in 1995, and owns an 8.9% reversionary working interest after lease-wide payout is first achieved. Production from the first well in the block began in September 2000. Currently there are three wells producing at a combined rate of approximately 60 Mmcf of gas per day. A fourth well is currently being drilled. Before the Company is assigned its working interest, the initial working interest owners must achieve lease-wide payout of their investment. The Company expects payout to occur in the fourth quarter 2001 or first quarter 2002, however, if additional wells are drilled, payout may not occur until later in 2002.

Effective May 1, 2001 the Company increased its ownership in Drillmar Inc. from 37.5% to 64%. Consideration paid by the Company includes cash of approximately \$131,000, a contribution of services in the amount of \$298,000, and an undertaking to contribute an additional \$136,000 of cash and/or services. At June 30, 2001, Ivar Siem provided Drillmar \$100,000 and was issued an unsecured promissory note due December 31, 2001, bearing interest at 10% per annum. In July 2001, Drillmar was provided \$300,000 from Ivar Siem and \$200,000 from Harris Kaffie and were issued unsecured promissory notes due December 31, 2001, bearing interest at 10% per annum. The promissory note due to Harris Kaffie was paid on August 7, 2001. Accrued interest of \$986 was also paid to Mr. Kaffie in August 2001. The promissory notes issued by Drillmar are non recourse to the Company.

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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

LIQUIDITY AND CAPITAL RESOURCES

The following table summarizes the Company's financial position at June 30, 2001 and December 31, 2000 (amounts in thousands):

| | June 30, 2001 | | December 31, 2000 | |
|-------------------------------|---------------|-----|-------------------|-----|
| | Amount | % | Amount | % |
| Working capital | \$2,558 | 28 | \$1,388 | 15 |
| Property and equipment, net | 3,787 | 41 | 5,345 | 58 |
| Other noncurrent assets | 2,807 | 31 | 2,476 | 27 |
| Total | \$9,152 | 100 | \$9,209 | 100 |
| Other non-current liabilities | \$ -- | -- | \$ 550 | 6 |
| Minority interest | 1,212 | 13 | 1,196 | 13 |
| Stockholders' equity | 7,940 | 87 | 7,463 | 81 |
| Total | \$9,152 | 100 | \$9,209 | 100 |

The change in the Company's financial position from December 31, 2000 to June 30, 2001, was primarily due to the sale of its' 50% interest in the Black Marlin Pipeline System.

Historically, the Company has relied on the proceeds from financing activities and the sale of assets to supplement its capital requirements. In the six months ended June 30, 2001 ("current period"), the Company financed its activities through both the sale of assets and operating activities.

The Company's future cash flows are subject to a number of variables, including the level of production, utilization of its pipeline systems, utilization of the Company's services by third parties and commodity prices among others. The Company believes that it will have sufficient cash flow from operations, private equity or debt financing activities and the sale of assets to meet its obligations and operating needs for the current year. However, the Company cannot be assured that operations and other capital resources will provide cash in sufficient amounts to maintain planned levels of capital expenditures. The net cash provided by or used in our operating, investing and financing activities is summarized below (amounts in thousands):

| Six Months Ended | |
|------------------|------|
| June 30 | |
| 2001 | 2000 |

Net cash provided by (used in):

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| | | |
|----------------------|----------|--------|
| Operating activities | \$ 447 | \$ 534 |
| Investing activities | 3,360 | (595) |
| Financing activities | (2,125) | 94 |
| | ----- | ----- |
| Net increase in cash | \$ 1,682 | \$ 33 |
| | ===== | ===== |

The Company's cash flow from operating activities decreased by \$0.1 million in the current period compared to the six months ended June 30, 2000 ("previous period"), due primarily to the decrease in cash flow from abandonment costs offset in part by the increased cash flow generated from the Company's American Resources oil and gas properties.

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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

Cash flow provided by investing activities during the current period included the proceeds from the sale of the Company's interest in the Black Marlin Pipeline System of approximately \$4.6 million. Cash flow used in investing activities included the construction of a new offshore platform installed to operate the Blue Dolphin Pipeline of approximately \$1.5 million, investment costs associated with Drillmar of approximately \$0.2 million and exploration and development costs associated with an American Resources oil and gas property of approximately \$0.3 million.

Cash flow used in financing activities during the current period consisted of the payment of promissory notes in the principal amount of approximately \$2.2 million, see Item 1., Note 1., Related Party Transactions.

On January 22, 2001, the Company and its partners sold the Black Marlin Pipeline System for \$7.3 million, and the High Island Block A-5 lateral constructed in 2000 for \$2.0 million, to Williams Field Services; \$3.6 million and \$1.0 million, respectively, net to the Company's interest. The Black Marlin System accounted for 15% of the Company's revenues in the previous period.

In November 2000, the Company elected to abandon the Buccaneer Field due to adverse developments in the field. The Company reached an agreement with Tetra to plug and abandon the wells in the field. In the current period the remaining wells in the Buccaneer Field were plugged and abandoned for approximately \$1.4 million. The Company used its escrow fund for abandonment obligations to fund the plugging of the Buccaneer Field wells. In addition, Maritech Resources, Inc. ("Maritech") an affiliate of Tetra, purchased an adjacent lease for which the Company provided production operating services. In December 2000, as a result of the Company's plans to abandon the Buccaneer Field platform facilities, the Company and Maritech terminated the operating agreement. A new platform was installed in the current period in Galveston Block 288 to operate and maintain the Blue Dolphin Pipeline System. The Blue Dolphin Pipeline System was previously tied into and operated from the Buccaneer Field platforms. The installation of the new platform and its connection to the Blue Dolphin Pipeline System cost approximately \$1.5 million net to the Company's 50% interest.

In August 2001, the Company reached an agreement with Tetra to remove the Buccaneer Field platforms for a cost of approximately \$2.6 million. In addition, Tetra extended payment terms, whereby the Company will pay 20% upon completion and 5% per month for twelve months, with the remaining balance due in the

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thirteenth month. To provide security for the extended payment, the Company is providing Tetra with a first lien on its interest in the Blue Dolphin Pipeline System. The Company will continue to seek extended payment arrangements for certain of its remaining abandonment costs estimated to be \$2.5 million.

In December 1999, the Company entered into an agreement with Fidelity Oil to manage their interest in the oil and gas properties acquired from American Resources for \$40,000 per month. This amount was intended to reimburse the Company for the cost of the services provided. The agreement expired in December 2000 and provided for continuation thereafter on a year to year basis unless terminated by either party. Fidelity Oil terminated this agreement effective January 31, 2001.

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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 Company's reserves and future net revenues reported at December 31, 2000 reflect capital expenditures totaling \$898,900 for the year ending December 31, 2001. Management will continue to evaluate its capital expenditure program based on, among other things, field reservoir performance, availability and cost of drilling and workover equipment, and demand and prices obtainable for the Company's production, as well as availability of capital resources. There can be no assurance that reserves will be developed as currently planned. At June 30, 2001, the Company incurred capital expenditures totaling 387,000 which was associated with the development of its interest in the American Resources' Galveston Block 418 property. The Company currently believes that capital expenditures for the second half of 2001 will be \$753,000.

In December 1999, American Resources was paid approximately \$4.5 million by Blue Dolphin Exploration for American Resources common stock, representing a 75% ownership interest, and \$24.2 million by Fidelity Oil for an 80% interest in its' Gulf of Mexico assets. The proceeds were used by American Resources to retire certain indebtedness. The indebtedness included American Resources senior secured debt totaling approximately \$51.2 million to Den norske bank ("Den norske"). Den norske sold the senior debt for \$27.0 million and a contingent future payment if the cumulative net revenues received by American Resources and Fidelity Oil attributable to American Resources proved oil and gas reserves in the Gulf of Mexico as of January 1, 1999, exceed \$30.0 million during the period January 1, 1999, through December 31, 2001. If that occurs Den norske will be entitled to receive an amount equal to 50% of the net revenues in excess of \$30.0 million during that three-year period. If any contingent amount becomes payable to Den norske, 80% will be paid by Fidelity Oil and 20% will be paid by American Resources. The payment, if any, is due on March 15, 2002. American Resources estimates that it is probable that a payment to Den norske will be due based upon current market conditions. The Company has provided for a liability to Den norske in the amount of \$850,000 at June 30, 2001.

The Company believes that it has, or can obtain, adequate capital to continue to meet its anticipated capital requirements. In the past, the Company's requirements have been financed by the disposition of certain assets, for example, interests in its pipelines, by borrowings from a commercial bank, private placements of its equity and debt securities, and investments by its directors. However, there can be no assurance that the Company will be able to continue to obtain financing from these sources or sell assets on commercially acceptable terms. The Company's inability to finance its capital requirements

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may adversely affect its' results of operations, timing for major pipeline expansions, growth in oil and gas prospect generation activities, developmental midstream projects and other projects.

RESULTS OF OPERATIONS

The Company reported net income for the six months ended June 30, 2001, ("current period") of \$483,508, compared to net income of \$203,534 reported for the six months ended June 30, 2000 ("previous period"). The difference in net income is primarily due to the gain on the sale of the Black Marlin Pipeline System of \$1,417,626 offset in part by a current period increase to the Company's Buccaneer Field abandonment obligations of approximately \$1,100,000.

For the quarter ended June 30, 2001 ("current quarter") the Company reported a net loss of \$69,406 compared to net income of \$150,697 for the quarter ended June 30, 2000 ("previous quarter"). The reduction is due to decreases in pipeline transportation revenues in the current quarter from the sale of the Black Marlin Pipeline System in January 2001 and the consolidation of Drillmar Inc. which had an operating loss of \$61,968, (net of minority interest) for the quarter ended June 30, 2001.

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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

Revenues:

First Half 2001 vs. First Half 2000. Current period revenues from oil and gas sales increased by \$1,075,652, from those of the previous period. Revenues from American Resources properties increased by \$1,308,090 in the current period compared to the previous period due to a 60% increase in commodity prices on a million cubic feet of gas equivalent basis ("Mmcfe"), resulting in increased revenues of \$1,222,620 and an increase in production volumes of 8% on an Mmcfe basis, resulting in a \$155,760 increase in revenues. The increase in oil and gas sales in the current period was partially offset by loss of revenues from the Buccaneer Field, which were \$233,759 in the previous period.

Current period revenues from pipeline operations decreased by \$505,006 or 48% from the previous period. The decrease was due to the sale of the Black Marlin Pipeline System on January 22, 2001. The Black Marlin Pipeline System provided revenues of \$568,776 for the previous period compared to \$49,640 for the current period.

The Company did not have current period revenues from operating fees due to the termination of the operating agreement with Maritech in December 2000.

Second Quarter 2001 vs. Second Quarter 2000. Current quarter revenues from oil and gas sales increased by \$320,509, from those of the previous quarter. Revenues from American Resources properties increased by \$443,877 in the current quarter compared to the previous quarter due to a 62% increase in gas prices. The increase in oil and gas sales in the current quarter was partially offset by loss of revenues from the Buccaneer Field, which were \$123,368 in the previous quarter.

Current quarter revenues from pipeline operations decreased by \$356,358 or 61% from the previous quarter. The decrease was primarily due to the sale of the

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Black Marlin Pipeline System on January 22, 2001. The Black Marlin Pipeline System provided revenues of \$337,327 for the second quarter of 2000 compared to no revenues for the current quarter.

The Company did not have current quarter revenues from operating fees due to the termination of the operating agreement with Maritech in December 2000.

Costs and Expenses:

First Half 2001 vs. First Half 2000. Current period pipeline operating expenses decreased by \$237,297 or 47% from the previous period. The decrease was primarily due to the sale of Black Marlin Pipeline System on January 22, 2001. Black Marlin Pipeline System operating expenses were \$244,474 for the previous period compared to \$33,462 for the current period.

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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

Current period depletion, depreciation, amortization and abandonment increased \$1,092,036 from the previous period. The increase was due to an 8% increase in production volumes resulting in increased depletion of \$68,103 offset in part by a decrease of \$83,223, resulting from the sale of the Black Marlin Pipeline System. The Company recorded depletion expense of \$33,916 in the previous period for the Buccaneer Field. The Company recorded an increase in the estimated costs associated with the Buccaneer Field abandonment of approximately \$1,100,000 in the current period. During the current period, the Company plugged and abandoned the remaining Buccaneer Field wells for a total cost of approximately \$1.4 million. In addition, the Company estimates cost of \$5.1 million to remove the Buccaneer Field platforms. At December 31, 2000, the provision for abandonment was approximately \$5.4 million, thus the Company has recorded an adjustment to the estimated abandonment cost of approximately \$1,100,000 in the current period.

General and administrative expenses for the current period increased \$525,431 from the previous period. The increase was due in part to an increase in legal expense associated with the H&N lawsuit of approximately \$74,000 and the termination of the Management Services Agreement between the Company and Fidelity Oil, whereby the Company managed Fidelity Oil's interest in the oil and gas assets it acquired from American Resources in December 1999, resulting in an increase of approximately \$200,000. The management fees received from Fidelity Oil had been recorded as a reduction to general and administrative expenses. In addition, general and administrative expenses of \$299,472 were recorded in the current period as a result of the consolidation of Drillmar.

Interest and other expense increased \$273,161 in the current period due to a \$300,000 increase in the provision for the contingent payment to Den norske Bank.

Second Quarter 2001 vs. Second Quarter 2000. Current quarter pipeline operating expenses decreased by \$147,042 or 55% from the previous quarter. The decrease was primarily due to the sale of the Black Marlin Pipeline System on January 22, 2001.

Current quarter depletion, depreciation and amortization decreased \$29,856 from the previous quarter. The decrease was primarily due to decrease of \$49,934,

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resulting from the sale of the Black Marlin Pipeline System.

General and administrative expenses for the current quarter increased \$205,463 from the previous quarter. The increase was primarily due to expenses of \$110,538 recorded in the current quarter associated with Drillmar and the termination of the Management Services Agreement between the Company and Fidelity Oil, whereby the Company managed Fidelity Oil's interest in the oil and gas assets it acquired from American Resources in December 1999, resulting in an increase of approximately \$120,000. The management fees received from Fidelity Oil had been recorded as a reduction to general and administrative expenses.

Interest and other expense increased \$131,816 in the current quarter due to a \$150,000 increase in the provision for the contingent payment to Den norske Bank.

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BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET PRICE

The Company is exposed to market risk, including adverse changes in commodity prices and interest rates as discussed below.

Commodity Price Risk- The Company produces and sells natural gas, crude oil, and natural gas liquids. As a result, the Company's financial results can be significantly affected if these commodity prices fluctuate widely in response to changing market forces. The Company does not use derivative products to manage commodity price risk.

Interest Rate Risk- The Company currently has no short-term or long-term debt with floating interest rates, and is not subject to risk of interest rate changes.

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BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On May 8, 2000, American Resources, a 77% indirectly owned subsidiary of the Company, and its former Chief Financial Officer, were named in a lawsuit in the United States District Court for the Southern District of Texas, Houston Division, styled H&N Gas and Howard Energy Marketing, L.L.C. v. American Resources Offshore, Inc. et al (Case No H-00-1371). The lawsuit alleges, among other things, that H&N Gas ("H&N") was defrauded by American Resources in connection with gas purchase options and gas price swap contracts entered into from February 1998 through September 1999. H&N alleges unlawful collusion between American Resources' prior management and the then president of H&N, Richard Hale ("Hale"), to the detriment of H&N. H&N generally alleges that Hale directed H&N to purchase illusory options from American Resources that bore no relation to any physical gas business and that American Resources did not have

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the financial resources and/or sufficient quantity of gas to perform. H&N further alleges that American Resources and Hale colluded with respect to swap transactions that were designed to benefit American Resources at the expense of H&N Gas. H&N further alleges civil conspiracy against all the defendants. H&N is seeking approximately \$6.2 million in actual damages plus treble damages, punitive damages, prejudgment interest and attorneys' fees against American Resources directly. As a result of its conspiracy allegation, H&N also contends that all defendants are jointly and severally liable for over \$62.0 million dollars in actual damages plus treble damages, punitive damages, prejudgment interest and attorneys' fees. American Resources intends to vigorously defend this claim.

ITEM 5. OTHER INFORMATION

During the second quarter of 2000, American Resources' Board of Directors formed a special committee for the purpose of evaluating the possible exchange of its' outstanding common stock and preferred stock for shares of the common stock of the Company. The special committee is made up of American Resources' directors who are not affiliated with the Company.

On August 6, 2001, the Company and American Resources reached an agreement in principle for the Company to acquire by merger all outstanding shares of American Resources' common stock not owned by the Company and all outstanding shares of American Resources' Series 1993 8% Convertible Preferred Stock. The agreements in principle calls for the holders of American Resources' common stock to receive one share of Blue Dolphin common stock for each 36.2 shares of American Resources common stock owned and for holders of American Resources' preferred stock to receive one share of Blue Dolphin common stock for each 33.2 shares of American Resources preferred stock owned. If the proposed merger is completed, American Resources will become a wholly-owned subsidiary of the Company and former stockholders of American Resources will become stockholders of the Company. The proposed merger is subject to, among other things, execution of a definitive merger agreement and approval of the merger by American Resources' stockholders.

ITEM 6. EXHIBITS AND REPORT ON FORM 8-K

- A) No Exhibits
- B) Form 8-K - None

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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: August 20, 2001

/s/ Michael J. Jacobson

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Michael J. Jacobson
President and Chief Executive Officer

/s/ G. Brian Lloyd

G. Brian Lloyd
Vice President, Treasurer