

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

BLUE DOLPHIN ENERGY CO
Form 10-K405/A
January 11, 2001

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

FORM 10-K/A-3

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

For the fiscal year ended December 31, 1999

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 73-1268729
(State or other jurisdiction of (I.R.S. Employer Identification No.)
incorporation or organization)

801 Travis, Suite 2100, Houston, Texas 77002
(Address of principal executive office) (Zip Code)

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

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:
common stock \$.01 par value
(Title of Class)

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

Yes No

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

The aggregate market value (estimated solely for purposes of this
calculation) of the voting stock held by non-affiliates of the registrant as of
January 4, 2001, was approximately \$12,246,793.

As of January 4, 2001, there were outstanding 6,045,326 shares of
common stock, par value \$.01 per share, of the registrant.

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

DOCUMENTS INCORPORATED BY REFERENCE

The registrant's definitive proxy statement for the 2000 Annual Meeting of Stockholders of the registrant (Sections entitled "Ownership of Securities of the Company", "Election of Directors", "Executive Compensation" and "Transactions With Related Persons"), filed with the Securities and Exchange Commission pursuant to Regulation 14A, is incorporated by reference in Part III of this report.

PART I

ITEM 1. BUSINESS

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 the 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, uncertainties and assumptions, including but not limited to industry conditions, prices of crude oil and natural gas, regulatory changes, general economic conditions, interest rates, competition, and other factors discussed below. Should one or more of these risks or uncertainties materialize or should the underlying assumptions prove incorrect, actual results and outcomes may differ materially from those indicated in the forward-looking statements. 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 obligation to publish revised forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events. Readers are also urged to carefully review and consider the various disclosures made by the Company which attempt to advise interested parties of the additional factors which 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, as well as the Company's periodic reports on Forms 10-Q and 8-K filed with the Securities and Exchange Commission.

THE COMPANY

The Company is engaged in the acquisition and exploration of oil and gas properties, and the gathering, transportation and storage of natural gas and condensate. The Company is actively pursuing midstream projects with long term revenue potential, such as the Petroport offshore oil terminal and the Avoca natural gas storage project. The Company's primary geographical focus areas are the western and central coasts of the U.S. Gulf of Mexico. The Company was incorporated in 1986 as the result of the corporate combination of ZIM Energy Corporation, a Texas corporation founded in 1983, and Petra Resources, Inc., an Oklahoma corporation formed in 1980. The Company succeeded to the business, properties and assets of ZIM Energy and Petra Resources. In June 1987, the Company changed its name from ZIM Energy Corporation to Mustang Resources Corp. In January 1990, the Company's name was changed to Blue Dolphin Energy Company. In December 1999, the Company acquired a 75% ownership interest in American Resources Offshore, Inc.

The Company is a holding company that conducts substantially all of its operations through its subsidiaries. Substantially all of the Company's assets consist of equity in its subsidiaries. The Company's subsidiaries are as follows:

- o Blue Dolphin Exploration Company, a Delaware corporation,
- o American Resources, a majority owned subsidiary of Blue Dolphin Exploration;
- o Blue Dolphin Pipe Line Company, a Delaware corporation;
- o Blue Dolphin Services Co., a Texas corporation;
- o Black Marlin Energy Company, a Delaware corporation,
 - o Black Marlin Pipeline Company, a Texas corporation and wholly owned subsidiary of Black Marlin Energy;
- o Buccaneer Pipe Line Co., a Texas corporation;
- o Mission Energy, Inc., a Delaware corporation;
- o New Avoca Gas Storage, LLC, a Texas Limited liability company in which the Company owns a 25% interest; and
- o Petroport, Inc., a Delaware corporation.

The principal executive office of the Company is located at 801 Travis, Suite 2100, Houston, Texas, 77002, telephone number (713) 227-7660. American Resources maintains a division office in New Orleans, Louisiana. Shore base facilities are maintained in Freeport and Texas City, Texas serving Gulf of Mexico operations. The Company has 24 full-time employees. The Company's Common Stock is traded on the National Association of Securities Dealers, Inc. Automated Quotation System ("NASDAQ") Small Cap Market under the trading symbol "BDCO". The Company's home page address on the world wide web is <http://www.blue-dolphin.com>.

BUSINESS AND PROPERTIES

The Company conducts its business activities in two primary business segments: (i) pipeline operations, which includes our developmental mid-stream projects, and (ii) oil and gas exploration and production. The Company owns and operates, through its subsidiaries, natural gas and condensate pipeline gathering facilities. The Company's oil and gas exploration and production activities include the exploration, acquisition, development, operation and, when appropriate, disposition of oil and gas properties. The Company also develops for sale to third parties, oil and gas exploration prospects in the Gulf of Mexico. See Note 10 to Consolidated Financial Statements included in Item 8 and incorporated herein by reference for information relating to revenues, operating profit or loss and identifiable assets of the Company's business segments. The Company is also in varying stages of development of the Petroport offshore oil terminal project and the Avoca natural gas storage project.

PIPELINE OPERATIONS AND ACTIVITIES

The Company's pipeline assets are held and operations conducted by Blue Dolphin Pipe Line Company, Mission Energy, Buccaneer Pipe Line and Black Marlin, all wholly owned subsidiaries of the Company.

PURCHASE AND SALE OF PIPELINE INTERESTS. On March 1, 1999, the Company acquired Black Marlin Pipeline Company from Enron Pipeline Company ("Enron"),

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

for \$5,404,270. In addition, Enron received an option to acquire a minimum of 25% and a maximum of 33-1/3% of the Black Marlin Pipeline System, if Black Marlin Pipeline should become no longer subject to rate and tariff regulation by the Federal Energy Regulatory Commission (the "FERC"). This option will expire on the earlier of the third anniversary of the date of notice that the Black Marlin Pipeline is no longer subject to rate and tariff regulation or March 1, 2004. Black Marlin Pipeline Company is the owner of the 75-mile Black Marlin Pipeline System, as defined below. Effective as of March 1, 1999, the Company sold

- o a one-sixth (1/6) undivided interest in the Company's Blue Dolphin Pipeline System, the Black Marlin Pipeline System and the Omega Pipeline to WBI Southern, Inc. ("WBI") for \$3,712,000, and
- o a one-third (1/3) undivided interest in the Black Marlin Pipeline System to MCNIC Pipeline and Processing Company ("MCNIC") for \$1,801,423.

The Company used the proceeds from these transactions to finance its acquisition of Black Marlin Pipeline Company. MCNIC owns a one-third (1/3) interest in the Blue Dolphin Pipeline System and the Omega Pipeline. Neither WBI nor MCNIC is an affiliate of the Company.

BLUE DOLPHIN PIPELINE SYSTEM. The Company, through Blue Dolphin Pipe Line Company, Mission Energy and Buccaneer Pipe Line, owns a 50% undivided interest in the Blue Dolphin Pipeline System (the "Blue Dolphin System"). The Blue Dolphin System includes the Blue Dolphin Pipeline, Buccaneer Pipeline, onshore facilities for condensate and gas separation and dehydration, 85,000 Bbls of above-ground tankage for storage of condensate, a barge loading terminal on the Intracoastal Waterway and 360 acres of land in Brazoria County, Texas where the Blue Dolphin Pipeline comes ashore and where the pipeline system shore facilities, pipeline easements and rights-of-way are located.

The Blue Dolphin System gathers and transports natural gas and condensate from the Buccaneer Field and other offshore fields in the area to shore facilities located in Freeport, Texas. After processing, the gas is transported to an end user and a major intrastate pipeline system with further downstream tie-ins to other intrastate and interstate pipeline systems and end users. The Buccaneer Pipeline, an 8" condensate pipeline, transports condensate from the storage tanks to the Company's barge loading terminal on the Intracoastal Waterway near Freeport, Texas for sale to third parties.

The Blue Dolphin Pipeline consists of two segments. The offshore segment transports both natural gas and condensate and is comprised of approximately 36 miles of 20-inch pipeline from the Buccaneer Field platforms to shore and 4 miles to the shore facility at Freeport, Texas. Additionally, the offshore segment includes 9 field gathering lines totaling approximately 55 miles, connected to the main 20-inch line. This system's onshore segment consists of approximately 2 miles of 16-inch pipeline for transportation of natural gas from the shore facility to a sales point at a Freeport, Texas chemical plants' complex and intrastate pipeline system tie-in.

4

Various fees are charged to producer/shippers for provision of transportation and shore facility services. Blue Dolphin System natural gas throughput averaged approximately 21% of capacity during 1999. Current system capacity is approximately 160 MMcf per day of gas and 7,000 Bbls per day of condensate. During 1999, 99% of gas and condensate volumes transported were attributable to production from third party producer/shippers. See Note 10 to Consolidated Financial Statements included in Item 8 and incorporated herein by reference.

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

BLACK MARLIN PIPELINE SYSTEM. Black Marlin is the owner of the Black Marlin Pipeline System (the "Black Marlin System"). The Black Marlin System includes the Black Marlin Pipeline, onshore facilities for condensate and gas separation and dehydration, 3,000 Bbls of above ground tankage for storage of condensate, a truck loading facility for oil and condensate, and 5 acres of land in Galveston County, Texas where the Black Marlin Pipeline comes ashore and on which are located the pipeline system's shore facilities.

Black Marlin is classified as a "natural gas company" pursuant to the Natural Gas Act of 1938 and the Black Marlin Pipeline is classified as an "interstate pipeline" pursuant to the Natural Gas Policy Act of 1978 and thus subject to FERC regulation.

Gas and condensate from various producer/shippers in the High Island and Galveston Areas of the Gulf of Mexico are gathered and transported through the Black Marlin Pipeline to its shore facilities. After separation and dehydration, gas is transported to an industrial end user or to either of two major intrastate pipeline systems with further downstream tie-ins to other intrastate and interstate pipeline systems and end users. Condensate is either delivered to a liquids pipeline or transported by truck.

The Black Marlin Pipeline consists of two segments. The offshore segment transports natural gas and condensate and is comprised of approximately 67 miles of 16-inch pipeline from a High Island Block 136 platform, including an extension from a platform in High Island Block A-6, to an interconnection in High Island Block 137, across Galveston Bay to the onshore facilities at Texas City, Texas. The offshore segment also includes approximately 7 miles of 8-inch pipeline from a platform in High Island Block 199 to an interconnection with the main line in High Island Block 171. The onshore segment consists of approximately 2 miles of 16-inch pipeline from the shore facilities to an end user and pipeline system tie-ins.

Various fees are charged to producer/shippers for provision of transportation and shore facility services. Black Marlin System natural gas throughput averaged approximately 28% of capacity during 1999. Current Black Marlin System capacity is approximately 200 MMcf per day of gas and 1,500 Bbls per day of condensate. During 1999, all gas and condensate volumes were attributable to production from third party producer/shippers.

OTHER. The Company also holds a 50% undivided interest in the currently inactive Omega Pipeline, MCNIC holds a one-third (1/3) interest and WBI holds a one-sixth (1/6) interest. The Omega Pipeline originates in West Cameron Block 342 and extends to High Island, East Addition Block A-173, where it was previously connected to the High Island Offshore System ("HIOS"). The line could either be reconnected to HIOS, or a lateral pipeline could be constructed connecting into the Black Marlin Pipeline approximately 14 miles to the west. Reactivation of the Omega Pipeline will be dependent upon future drilling activity in the vicinity and successfully attracting reserves to the system.

5

The economic return to the Company on its pipeline system investments is solely dependent upon the amounts of gas and condensate gathered and transported through the pipeline systems. Competition for provision of gathering and transportation services, similar to those provided by the Company, is intense in the market areas served by the Company. See Competition, Markets and Regulation - Competition below. Since contracts for provision of such services between the Company and third party producer/shippers are generally for a specified time period, there can be no assurance that current or future producer/shippers will not subsequently tie-in to alternative transportation systems or that current rates charged by the Company will be maintained in the future. The Company

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

actively markets gathering and transportation services to prospective third party producer/shippers in the vicinity of its pipeline systems. Future utilization of the pipelines and related facilities will depend upon the success of drilling programs around the pipelines, and attraction, and retention, of producer/shippers to the systems.

MIDSTREAM DEVELOPMENT PROJECTS

PETROPORT PROJECT

The Company's investment in and development of an offshore crude oil terminal is through Petroport. In March 1995, the Company acquired Petroport, L.C. The form of the transaction was a merger of Petroport, L.C. into Petroport. Petroport holds proprietary technology, represented by certain patents issued and or pending, associated with the development and operation of a deepwater crude oil and products port and offshore storage facility. The Petroport deepwater terminal will receive crude oil offshore with deliveries to shore by pipeline. Onshore the Petroport pipeline will connect with an existing onshore storage and distribution network, accessing Texas Gulf coast and Mid-Continent refining centers.

In October 1999, the Company announced that Equilon Enterprises, LLC (an alliance of two major oil companies, Shell and Texaco), agreed to jointly continue development of the Petroport deepwater port project with the Company. The agreement provided that the parties would share mutually agreed upon third party costs for additional economic feasibility and design studies for the purpose of determining whether to proceed with further development efforts, including licensing and permitting of the facility. The same agreement contemplated that the parties would enter into further contractual arrangements in the event that Equilon chose to participate in the substantial additional costs of proceeding with licensing of the facility, and that Equilon would have no interest in the Petroport project if it did not. The agreement contemplated that those additional contracts would address such matters as the parties' respective ownership percentages of an entity to be formed to develop, own and operate Petroport, the sharing of further development costs and cash payments to the Company. Proposed, non-binding terms concerning those matters were contained in the agreement but were subject to substantial change depending upon, among other things, whether the Company or Equilon determined to sell a portion of their respective interests in the project to other participants. Although the Equilon agreement expired in December 1999, Equilon and the Company continued to share relatively minor development expenses, although neither party was obligated to do so. Costs of the offshore terminal complex, the pipeline to shore, onshore facilities and facility licensing are estimated to be \$200.0 million. Equilon has not advised the Company as to whether it will proceed with licensing and further documentation. Whether Equilon determines to participate further in the development of Petroport, the Company intends to continue its efforts to attract throughput commitments from prospective users.

As currently planned, the facility will be located 40 miles off the Texas coast in approximately 115 feet of water. The terminal complex will consist of two single point mooring buoys connected to a central pumping platform, with a main export pipeline from the platform to shore facilities in the

6

Freeport, Texas area. At its onshore terminus, the main oil pipeline will access existing onshore storage and a distribution network serving the greater Houston area refiners and the NYMEX crude oil futures settlement hub at Cushing, Oklahoma. The design capacity of the pipeline to shore will be in excess of 1.25 million barrels per day.

Petroport's future business environment is expected to be characterized by

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

a continuing significant demand by refiners for imports, with use of short haul Caribbean Basin crudes as a major source of foreign crude. Petroport will offer an alternative for receipt of large volumes of imported crude oil. The Company believes Petroport's commercial success will be driven primarily by economies of scale derived from use of larger, fully loaded tankers discharging short haul Caribbean Basin cargoes into Petroport, and efficiencies gained by supertankers discharging intermediate and long haul West African, North Sea, and Persian Gulf crudes directly into Petroport versus current use of lightering operations.

Petroport will also be available to serve producers in the Gulf of Mexico. It can serve as a major gathering hub and trunk line to shore, with crude received from floating production storage and offloading systems serving deepwater Gulf of Mexico producers.

Presently, the Company does not have a partner to participate in the development of Petroport. However, the Company is actively soliciting major oil and gas companies that import large volumes of crude oil and various other entities to participate in the ownership and further costs of development. The Company currently estimates that licensing and permitting costs for the offshore port facility will be approximately \$6.0 million and expects that its partner or partners in the Petroport project would be responsible for the licensing and permitting costs. The Company plans to seek financing for the costs associated with facility construction, and expects that any such financing would be based on the throughput commitments from prospective users. However, there can be no assurance that the Company will be able to obtain either a partner and the necessary throughput commitments to proceed with the development of Petroport.

In the process of evaluating and soliciting prospective partners for the Petroport project, the Company has identified a second market for an offshore crude oil port, located off the coast of Port Arthur, Texas. This facility would be designed to fill a niche created by long term arrangements for the supply of short haul Caribbean Basin crude oil delivered to congested shallow water port complexes. This port would target the smaller tankers used in the short haul trade. The Company has completed preliminary conceptual design and costing work, and a general commercial assessment for this project. In addition to the licensing and permitting costs, the Company estimates that the construction costs for this facility will be approximately \$200.0 million. Presently, the Company is working with a major potential user regarding the development of this facility. The Company does not intend to proceed with the development of this project without a major use commitment and support of a partner. There can be no assurance that the Company will be able to obtain such use commitment or a partner for the project.

AVOCA NATURAL GAS STORAGE PROJECT

In November 1999 the Company and WBI Holdings, Inc. ("WBI Holdings") formed New Avoca Gas Storage LLC ("New Avoca"), 25% owned and managed by the Company and 75% owned by WBI Holdings, and acquired the Avoca gas storage assets. The Company records its investment in New Avoca by using the equity method of accounting.

7

The Avoca natural gas salt cavern storage project was conceived as a 5 BCF working gas facility located south of Rochester near the town of Avoca, New York. Its design provides for 250 MMcf/d injection and 500 MMcf/d withdrawal capacities into the Tennessee Gas Pipeline HC400 24" line.

The original owner, Avoca Gas Storage, Inc., filed for bankruptcy on July 7, 1997. The assets were subsequently acquired out of bankruptcy by Northeastern Gas Caverns ("Northeastern").

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

New Avoca purchased the Avoca gas storage assets from Northeastern for \$400,000 plus a contingent payment of \$500,000. On June 28, 2000 the United States Bankruptcy Court for the District of Delaware held a hearing to approve a settlement agreement between Avoca Gas Storage, the Committee of Unsecured Creditors, and an affiliate of Northeastern. The contingent payment of \$500,000, \$125,000 net to the Company's interest in New Avoca, was due to Northeastern on May 22, 2000. New Avoca made a payment of \$50,000 and extended the remaining \$450,000 payment to August 22, 2000. In August 2000, Northeastern extended the contingent payment until October 2000 in exchange for increasing the contingent payment by \$10,000 to \$460,000. The contingent payment would be excused, and the \$40,000 net payment made would be refunded, if Northeastern successfully settles a claim associated with Avoca Gas Storage, Inc. (the original owner of the Avoca gas storage assets). In October 2000, Northeastern received a payment on its claim and refunded the \$40,000 previously paid by New Avoca. New Avoca can elect to liquidate the project at any time.

The existing Avoca physical facilities include:

- o 900+ acres of land
- o Pumps and pipeline for fresh water
- o Pump house containing 12 pumps (6,400 HP) for the solution mining operation
- o 5 cavern wells - 4,000' deep
- o 6 brine disposal wells - 9,000' deep
- o Storage building with valves, fittings, and miscellaneous parts
- o Electrical switch gear
- o Solution mining equipment
- o Compressor foundations
- o Electrical Sub-Station

To create the salt caverns for storage of natural gas, pressurized water is injected from the surface to dissolve the salt formations below. The brine solution produced by this process must be continuously brought to the surface and then injected into underground disposal wells. The disposal wells must have sufficient porosity and permeability to accept the injected brine at a rate that will at least keep up with the rate at which brine is being produced during the creation of the salt caverns. The original owners of the Avoca gas storage assets conducted tests to determine the rate that the disposal wells would accept brine. New Avoca believes that the testing procedures used by the original owners of the project to analyze the rate at which the disposal wells could accept brine may have been flawed as a result of the accelerated pace at which the tests were conducted and therefore yielded test results that were uncertain and did not conclusively support an acceptable rate of brine disposal. The original owners of the Avoca gas storage assets encountered technical and other difficulties as a result of the uncertainty of their test results.

New Avoca recently completed an analysis of the project. Based on this analysis and recent technological advances, New Avoca believes the disposal wells will be capable of handling the more moderate rates of brine injection expected to be produced under its proposed construction schedule. In October 2000, New Avoca commenced testing of the disposal wells to determine the rate that these wells will accept brine. New Avoca estimates that the test of the disposal wells and the subsequent evaluation of the test results will take approximately two months to complete. Based on the results of the tests, New Avoca expects to make a decision to either proceed with or liquidate the project. If liquidated, the Company believes that it can recover its investment in this project. If the decision is

made to proceed with the project, New Avoca estimates that it will take between one and one-half to two years to begin operations at partial capacity, and three

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

to four years for the facility to operate at full capacity. However, until the Company has reviewed and analyzed the results from the tests of the disposal wells it will be unable to establish a definitive schedule or accurately estimate the costs to complete this project.

OIL AND GAS EXPLORATION AND PRODUCTION ACTIVITIES

The Company's oil and gas assets are held, and operations conducted by, Blue Dolphin Exploration and American Resources. The Company's oil and gas assets consist of leasehold interests in properties located offshore in the Gulf of Mexico. The leasehold properties held by the Company may be subject to royalty, overriding royalty and other outstanding interests customary in the industry. In the future the Company's properties may become subject to burdens such as liens incident to operating agreements and current taxes, development obligations under oil and gas leases and other encumbrances, none of which the Company believes will detract substantially from the value of the properties or materially interfere with their use in its operations. Certain terms that are commonly used in the oil and gas industry, including terms that define our rights and obligations with respect to each of the Company's properties, are defined in the "Glossary of Certain Oil and Gas Terms" on pages 18-19 of this Form 10-K.

The following is a description of the Company's major oil and gas exploration and production assets and activities:

AMERICAN RESOURCES. On December 2, 1999, Blue Dolphin Exploration acquired a 75% ownership interest in American Resources by purchasing approximately 39.0 million shares of American Resources common stock. The purchase price for the shares of American Resources' common stock was approximately \$4.5 million. Concurrently with the sale to Blue Dolphin Exploration, American Resources sold an 80% interest in its Gulf of Mexico assets to Fidelity Oil Holdings, Inc. a subsidiary of MDU Resources Group, Inc. The proceeds received by American Resources were used to retire certain indebtedness.

American Resources' assets consist of an average 6% non-operated working interest in eight producing properties and one proved undeveloped property along with leasehold interests in 34 additional offshore tracts, all located in the Gulf of Mexico offshore Louisiana and Texas. At closing, all significant liabilities of American Resources were settled and substantially all stock options and warrants were cancelled. The American Resources properties represent 41% of the discounted present value of estimated future net revenues from Proved Reserves of the Company as of December 31, 1999. Sales of production from the American Resources properties accounted for 52% of oil and gas sales revenues and 10% of total revenues of the Company for the year ended December 31, 1999.

American Resources sells substantially all of its current oil and gas production through the operators of its properties. The price American Resources is currently receiving is based on current market prices. Previously, forward sales contracts were utilized for a significant portion of its gas production to achieve more predictable cash flow and to reduce the effect of fluctuations in gas prices.

American Resources has established a preliminary budget of \$1.4 million for exploration and development of American Resources' oil and gas properties in 2000; however, this budget is subject to revision during the year to reflect drilling results and new opportunities. American Resources will evaluate each of the exploration and development opportunities and its available capital resources to determine whether to participate, sell its interest or sell a portion of its interest and use the proceeds to participate at a reduced interest.

THE BUCCANEER FIELD. In November 2000, the Company decided to abandon the

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

Buccaneer Field as a result of the occurrence of unforeseen adverse events. In July 2000, production from the

9

only producing well in the Buccaneer Field, the A-12 well, ceased due to down-hole mechanical problems. Due to the age of the A-12 wellbore, it is probable that a new well would be needed to restore production at the Buccaneer Field, at an estimated cost of \$2.8 million.

In addition, in October 2000, during the annual inspection by the U.S. Minerals Management Service ("MMS") of the two major platform complexes in the Buccaneer Field, the MMS notified the Company that certain repairs to the platforms must be made before operating activities can resume. The Company estimates the cost of these required, unplanned repairs to be in excess of \$1.0 million. However, the Company believes that if it elected to resume production from the Buccaneer Field the actual costs would have been approximately \$2.6 million, including an estimated \$.6 million to repair one of the platform complexes. Thus, the total cost to reestablish production would have increased to an estimated \$5.4 million, consisting of \$2.6 million in front-end infrastructure costs and \$2.8 million in drilling costs.

After considering the costs associated with drilling a new well to reestablish production, together with the unplanned cost of repairs to the platforms and the projected rate of production and discounted cash flow from the field, the Company has decided to abandon and not reestablish production from the Buccaneer Field. As a result of our decision to abandon and not to reestablish production from the Buccaneer Field, our lease on this field, pursuant to its terms, will terminate at the end of January 2001.

The Buccaneer Field is comprised of interests in parts of four lease blocks covering 14,660 acres located in the Gulf of Mexico approximately 36 miles south of Freeport, Texas. Operation of the field is conducted from two platforms located in waters averaging approximately 65 feet in depth.

The Company owns a 100% working interest in the Buccaneer Field (81.33% net revenue interest). The Buccaneer Field leasehold interests represent 59% of the discounted present value of estimated future net revenues from Proved Reserves of the Company as of December 31, 1999. Production from the Buccaneer Field accounted for 48% of the total revenues from oil and gas sales of the Company for the year ended December 31, 1999 and 100% for the years ended December 31, 1998 and 1997. See "Proved Oil and Gas Reserves" below. Buccaneer Field condensate and natural gas production is delivered to the Blue Dolphin System.

Natural gas produced from the Buccaneer Field was sold under a gas purchase contract dated May 1, 1991. The contract was extended through September 2000 at a variable monthly market price. In December 1999, the Company received a price of \$2.04/MMBtu. Buccaneer Field gas sales represented 42% of oil and gas sales revenues and 8% of total revenues of the Company for the year ended December 31, 1999.

Buccaneer Field condensate sales were based on the average monthly market price as reported by Koch Oil Company. Sale of condensate from the Buccaneer Field represented 6% of oil and gas sales revenues and 1% of total revenues of the Company for the year ended December 31, 1999.

The MMS requires that security be provided for the estimated future abandonment obligations associated with the Buccaneer Field. Blue Dolphin Exploration provided the MMS surety bonds in the amount of \$1,300,000. Additionally, Blue Dolphin Exploration was required to make a \$250,000 annual payment to a sinking fund to cover its end of lease abandonment and site clearance obligations. Blue Dolphin Exploration is required to make payments to

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

the sinking fund until the balance of the sinking fund is \$2,400,000, unless changed by the MMS. The MMS may periodically increase, or decrease, the amount of the sinking fund based upon its estimate of Blue Dolphin Exploration's lease abandonment and site clearance costs. In 1999, Blue Dolphin Exploration elected to remove an inactive satellite platform in the Buccaneer Field to reduce its future lease abandonment and site clearance costs. The Company's annual abandonment escrow fund payment of \$250,000 that was due in June 1999 was waived pursuant to a verbal agreement with the MMS as a result of the removal of

10

the inactive satellite platform. As of December 31, 1999, the sinking fund totaled approximately \$1,168,560.

In October 2000, the MMS notified the Company that they required additional security to ensure that its abandonment obligations associated with the Buccaneer Field will be met. The Company has escrowed approximately \$1.49 million for abandonment costs and provided \$1.3 million in surety bonds. At the request of the MMS, the Company has delivered an additional \$2.9 million in surety bonds and used the escrowed funds as collateral for the surety bonds.

In addition to conducting traditional oil and gas production operations for itself, the Company operates and maintains oil and gas production facilities for third party producers who also utilize the Blue Dolphin System for gathering and transportation of their production. The Company had a contract with Apache Corporation to provide operation and maintenance services that terminated in December 2000. During 1999, approximately 11% of the Company's revenues were attributable to its contract with Apache Corporation.

OFFSHORE OIL AND GAS PROSPECT GENERATION ACTIVITIES. In August 1994, Blue Dolphin Exploration initiated a program to develop oil and gas exploration prospects in the Gulf of Mexico for sale to third parties. The program utilizes 3-D seismic data. The Company owns a non-exclusive license to 150 blocks of 3-D seismic data covering 850,000 acres in the Western Gulf of Mexico and a substantial inventory of close grid 2-D seismic data. In addition to recovering prospect development costs, Blue Dolphin Exploration seeks to retain a reversionary working interest in each drillable prospect.

In September 1997, the Company entered into an agreement with Fidelity Oil, Western Production and Forcenergy (the "Participants"), whereby in exchange for certain participation rights, the Participants partially funded the costs associated with the Company's 1997/1998 offshore prospect generation program. The Company is obligated to, among other things, devote its best efforts to initiate, evaluate, document and present drilling prospects to the Participants. In order to enhance the productivity of the prospect generation program, during 1998 the Company transitioned from the use of consulting geologists and geophysicists to a 100% in house effort. This program was suspended in August 1998, as a result of the withdrawal of Forcenergy who filed for bankruptcy.

In 1999 the Company placed a 50% interest in the program with Fidelity Oil, whereby in exchange for certain participation rights, Fidelity Oil funds \$100,000 per month for the costs associated with the program. Program costs will be reimbursed to the Company as prospects are developed and leases acquired. A portion of the reimbursed costs will be paid to Fidelity Oil based on the level of interest it retains in each prospect. The available 50% interest in the generated prospects is for sale on an individual prospect basis. In April 2000, the Company amended the agreement with Fidelity Oil in its prospect generation program, whereby in exchange for certain participation rights of up to 100%, Fidelity Oil will fund, on a monthly basis, an aggregate of up to \$1,060,000 of the costs associated with the program during 2000. As of December 31, 2000 Fidelity Oil had paid \$1,069,888 of these costs. Fidelity Oil will also reimburse the Company for the expenses it incurs acquiring seismic data. The

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

available interests in the prospect inventory are for sale on an individual prospect basis.

The Company spent the first half of 1999 developing and marketing a prospect inventory in preparation for the Western Gulf of Mexico Federal Lease Sale held in August. Of the five prospects developed, one was sold in which the Company retained a reversionary working interest. Partial interests were sold in all of the pre-existing inventory of leased prospects. The Company is continuing to market the remaining interests. The Company's leased prospect inventory consists of prospects on the following offshore leases:

11

- o High Island Area Block A-8
- o Mustang Island Area Block 817
- o Mustang Island Area Block 839

The Company has reversionary interests in the following offshore leases:

- o High Island Area Block A-7
- o Galveston Area Block 297
- o Matagorda Island Area Block 713
- o Galveston Area Block 271
- o Galveston Area Block 284
- o Galveston Area Block 285
- o Matagorda Island Area Block 710

In November 2000, Fidelity Oil notified the Company that it was electing to withdraw from this program effective December 31, 2000. Presently, the Company is considering several alternatives including, but not limited to, finding new participants for the program and changes in the participation terms of the program. However, there can be no assurance that the Company will not suspend this program.

PROVED OIL AND GAS RESERVES. Estimates of proved reserves, future net revenues, and discounted present value of future net revenues to the net interest of the Company have been prepared as of December 31, 1999, by Netherland Sewell & Associates, Inc., Ryder Scott Company and the Company (Buccaneer Field). Both Netherland Sewell & Associates, Inc. and Ryder Scott Company are independent petroleum engineers.

The following table summarizes the estimates of Proved Reserves, Proved Developed Reserves (as hereinafter defined), future net revenues and the discounted present value of future net revenues from Proved Reserves before income taxes to the net interest of the Company in oil and gas properties as of December 31, 1999, using the SEC Method (defined below).

PROVED RESERVES INFORMATION
AS OF DECEMBER 31, 1999

| | NET OIL RESERVES (MB) | NET GAS RESERVES (MMCF) | FUTURE NET REVENUES (\$000) | DISCOUNTED F NET REVENUES (\$000) |
|-----------------------|-----------------------------|-------------------------------|-----------------------------------|---|
| Total Proved: (1) | | | | |
| ARO (4) | 145 | 4,349 | \$ 7,714 | \$ 6 |
| Buccaneer Field | 111 | 17,869 | \$ 25,726 | \$ 8 |

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

| | | | | |
|--|-------|--------|-----------|-------|
| TOTAL PROVED RESERVES | 256 | 22,218 | \$ 33,440 | \$ 14 |
| | ===== | ===== | ===== | ===== |
| Total Proved Developed Reserves: (2) | | | | |
| ARO (4) | 95 | 2,531 | \$ 5,078 | \$ 4 |
| Buccaneer Field | 111 | 17,869 | \$ 25,726 | \$ 8 |
| | ----- | ----- | ----- | ----- |
| TOTAL PROVED DEVELOPED RESERVES | 206 | 20,400 | \$ 30,804 | \$ 13 |
| | ===== | ===== | ===== | ===== |

MB = Thousand Barrels MMCF = Million Cubic Feet

12

- (1) "Proved Reserves" means the estimated quantities of oil, natural gas and condensate which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions.
- (2) "Proved Developed Reserves" are those quantities of oil, natural gas and condensate which are expected to be recovered through existing wells with existing equipment and operating methods.
- (3) The estimated future net revenues before deductions for income taxes from the Company's Proved Reserves have been determined and discounted at a 10% annual rate in accordance with requirements for reporting oil and gas reserves pursuant to regulations promulgated by the United States Securities and Exchange Commission (the "SEC Method"). See estimated future net revenues after deductions for income taxes in Note 11 to Consolidated Financial Statements of Blue Dolphin Energy Company and Subsidiaries.
- (4) The Company acquired a 75% ownership interest in American Resources on December 2, 1999. The above reflects 100% of American Resources' reserves and future net revenues, 25% of discounted future net revenues associated with total Proved Reserves and total Proved Developed Reserves of the American Resources' properties is \$1,525,252 and \$1,038,750, respectively.

The quantities of proved natural gas and crude oil reserves presented include only those amounts which the Company reasonably expects to recover in the future from known oil and gas reservoirs under existing economic and operating conditions. Therefore, Proved Reserves are limited to those quantities that are believed to be recoverable commercially at prices and costs, and under regulatory practices and technology existing at the time of the estimate. Accordingly, changes in prices, costs, regulations, technology and other factors could significantly affect the estimates of Proved Reserves and the discounted present value of future net revenues attributable thereto.

The reserves and future net revenues summarized above reflect capital expenditures totaling \$1,416,323, \$570,139, \$404,430, \$178,350 and \$43,300 in the years ending December 31, 2000, 2001, 2002, 2003 and 2004, respectively. Management will continue to evaluate its capital expenditure program based on, among other things, demand and prices obtainable for the Company's production. The availability of capital resources may affect the Company's timing for further development, and there can be no assurance that the timing of the development of such reserves will be as currently planned.

The discounted present value of estimated future net revenues attributable to Proved Reserves has been prepared in accordance with the SEC Method after deduction of royalties and other third-party interests, lease operating expenses, and estimated production, development, workover and recompletion costs, but before deduction of income taxes, general and administrative costs, debt service and depletion and amortization. Estimated future net revenues are

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

based on prices of oil and gas in effect at the end of the year without escalation except to the extent contractually committed. Lease operating expenses, and production and development costs, were estimated based on such costs in effect at the end of the year, assuming the continuation of existing economic conditions and without adjustment for inflation or other factors. The present value of estimated future net revenues is computed by discounting future net revenues at a rate of 10% per annum. Revenues from wells not currently producing are included at the time they are expected to be placed into production based upon estimates of future development; workover and recompletion costs are included at the time they are expected to be incurred. Of the Company's total Proved Developed Reserves, 8% of its estimated gas reserves and 29% of its estimated oil reserves were being produced at December 31, 1999.

13

Estimates of production and future net revenues cannot be expected to represent accurately the actual production or revenues that may be recognized with respect to oil and gas properties or the actual present market value of such properties. For further information concerning the Company's Proved Reserves, changes in Proved Reserves, estimated future net revenues and costs incurred in the Company's oil and gas activities and the discounted present value of estimated future net revenues from the Company's Proved Reserves, see Note 11 - Supplemental Oil and Gas Information to Consolidated Financial Statements included in Item 8 and incorporated herein by reference.

PRODUCTIVE WELLS AND ACREAGE. The following table sets forth the Company's interest in productive wells and developed and undeveloped acreage as of December 31, 1999.

ACREAGE AND WELLS

| | PRODUCTIVE WELLS (1) | | | | DEVELOPED | | UN |
|------------------------|----------------------|-------|-------|-------|-----------|--------|-------|
| | GROSS | | NET | | ACRES (1) | | A |
| | OIL | GAS | OIL | GAS | GROSS | NET | GROSS |
| American Resources (2) | 17 | 10 | 0.73 | 0.61 | 45,497 | 2,820 | 149,2 |
| Buccaneer Field | 0 | 1 | 0 | 1 | 8,730 | 8,730 | 5,9 |
| Other | 0 | 0 | 0 | 0 | 0 | 0 | 5,7 |
| | 17 | 11 | 0.73 | 1.61 | 54,227 | 11,550 | 160,8 |
| | ===== | ===== | ===== | ===== | ===== | ===== | ===== |

(1) "Productive wells" are producing wells and wells capable of production, and include gas wells awaiting pipeline connections or necessary governmental certifications to commence deliveries and oil wells to be connected to production facilities. "Developed acres" include all acreage as to which proved reserves are attributed, whether or not currently producing, but exclude all producing acreage as to which the Company's interest is limited to royalty, overriding royalty, and other similar interests. "Undeveloped acres" are considered to be those acres on which wells have not been drilled or completed to a point that would permit the production of commercial quantities of oil and gas regardless of whether such acreage contains Proved Reserves. "Gross" as it applies to wells or acreage refers to the number of wells or acres in which a working interest is owned, while "net" applies to the sum of the fractional working interests in gross wells or acreage.

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

- (2) The Company acquired a 75% ownership interest in American Resources on December 2, 1999. The above reflects 100% of American Resources' acreage and wells.

PRODUCTION, PRICE AND COST DATA. The following table sets forth the approximate production volumes and revenues, average sales prices and costs (after deduction of royalties and interests of others) with respect to crude oil, condensate, and natural gas attributable to the interest of the Company for each of the periods indicated:

14

NET PRODUCTION, PRICE AND COST DATA

| | YEAR ENDED DECEMBER 31, | | |
|------------------------------|-------------------------|------------|------------|
| | 1999 | 1998 | 1997 |
| Gas: | | | |
| Production (Mcf) | 169,329 | 177,260 | 176,986 |
| Revenue | \$ 393,125 | \$ 391,913 | \$ 393,444 |
| Average Mcf per Day | 463.9 | 485.6 | 484.9 |
| Average Sales Price | | | |
| Per Mcf | \$ 2.32 | \$ 2.21 | \$ 2.22 |
| Oil: | | | |
| Production (Bbls) | 6,338 | 1,628 | 1,156 |
| Revenue | \$ 151,974 | \$ 20,840 | \$ 21,636 |
| Average Bbls per day | 17.4 | 4.5 | 3.2 |
| Average Sales Price | | | |
| Per Bbl | \$ 23.98 | \$ 12.80 | \$ 18.72 |
| Production Costs (1): | | | |
| Per Equivalent Mcf (2): | \$ 4.14 | \$ 3.30 | \$ 4.16 |

(1) Production costs, exclusive of workover costs, are costs incurred to operate and maintain wells and equipment and to pay production taxes.

(2) Equivalent Mcf includes oil and condensate stated in terms of natural gas at the rate of one Bbl. of oil or condensate to six Mcf of natural gas.

DRILLING ACTIVITY. There was no drilling activity during 1999. There were two (.5 net) unsuccessful exploratory wells drilled in 1998, including one on a prospect generated and sold to third parties by the Company. There was no drilling activity during 1997.

The Company maintains a professional staff capable of supervising and coordinating the operation and administration of its oil and gas properties and pipeline and other assets. From time to time, major maintenance and engineering design and construction projects are contracted to third-party engineering and service companies.

COMPETITION, MARKETS AND REGULATION

COMPETITION

The oil and gas industry is highly competitive in all segments. Increasingly vigorous competition occurs among oil, gas and other energy sources, and between producers, transporters, and distributors of oil and gas. Competition is particularly intense with respect to the acquisition of desirable

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

producing properties and the marketing of oil and gas production. There is also competition for the acquisition of oil and gas leases suitable for exploration and for the hiring of experienced personnel to manage and operate the Company's assets. Several highly competitive alternative transportation and delivery options exist for current and potential customers of the Company's traditional gas and oil gathering and transportation business as well as for refiners, shippers, marketers and producers of crude oil whom the Company's proposed Petroport facility would serve.

15

Gas storage customers who would use the proposed Avoca Gas Storage system have alternatives, including depleted reservoir and salt cavern storage. Competition also exists with other industries in supplying the energy and fuel needs of consumers.

MARKETS

The availability of a ready market for natural gas and oil, and the prices of such natural gas and oil, depend upon a number of factors which are beyond the control of the Company. These include, among other things, the level of domestic production, actions taken by foreign oil and gas producing nations, the availability of pipelines with adequate capacity, the availability of vessels for lightering and transshipment and other means of transportation, the availability and marketing of other competitive fuels, fluctuating and seasonal demand for oil, gas and refined products, and the extent of governmental regulation and taxation (under both present and future legislation) of the production, importation, refining, transportation, pricing, use and allocation of oil, natural gas, refined products and alternative fuels.

Accordingly, in view of the many uncertainties affecting the supply and demand for crude oil, natural gas and refined petroleum products, it is not possible to predict accurately the prices or marketability of the natural gas and oil produced for sale or prices chargeable for transportation, terminaling and storage services, which the Company provides or may provide in the future.

GOVERNMENTAL REGULATION

The production, processing, marketing, and transportation of oil and natural gas, and planned terminaling and storage of crude oil and natural gas storage by the Company are subject to federal, state and local regulations which can have a significant impact upon the Company's overall operations.

FEDERAL REGULATION OF NATURAL GAS TRANSPORTATION. The transportation and resale of natural gas in interstate commerce have been regulated by the Natural Gas Act, the Natural Gas Policy Act and the rules and regulations promulgated by FERC. In the past the federal government has regulated the prices at which natural gas could be sold. In 1989, Congress enacted the Natural Gas Wellhead Decontrol Act, which removed all remaining Natural Gas Act and Natural Gas Policy Act price and non-price controls affecting producer sales of natural gas, effective January 1, 1993. Congress could, however, reenact price controls in the future.

The price and terms for access to pipeline transportation is subject to extensive federal regulation. In April 1992, the FERC issued Order No. 636, beginning a series of related orders, which required interstate pipelines to provide open-access transportation on a basis that is equal for all natural gas suppliers. The FERC has stated that it intends Order No. 636 to foster increased competition within all phases of the natural gas industry. Order No. 636 affects how buyers and sellers gain access to the necessary transportation facilities and how natural gas is sold in the marketplace. In 2000, the FERC issued Order No. 637 which, among other things, will permit pipelines to file for

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

peak/off-peak and term differentiated rate structures and changed existing regulations relating to scheduling procedures, capacity segmentation pipeline imbalance processes and penalties and pipeline reporting requirements.

The Company cannot predict whether the FERC's actions will achieve the goal of increasing competition in the natural gas markets or how these, or future, regulations will affect its operations or competitive position. However, the Company does not believe that any action taken will affect it in any way that materially differs from the way that such action affects the Company's competitors.

Of the natural gas pipelines owned by the Company, only the Black Marlin Pipeline is subject to rules and regulations of the Natural Gas Act. As a result, its gas transportation service and pricing

16

service are subject to the regulatory jurisdiction of the FERC. The previous owner of the Black Marlin Pipeline completed a FERC rate case which redetermined the rate the Company charges for use of its pipeline. As a result of the completion of the FERC case, the Company can expect a certain level of stability in the rates it charges. However, there is a trend toward greater competition among gas pipelines subject to the Natural Gas Act making it infeasible for regulated pipelines to rely upon exclusive monopoly status. Additionally, requirements of the Gas Industry Standards Board ("GISB") continue to evolve, and, along with Order No. 637 reporting and operational requirements, may impose additional obligations and costs upon interstate pipelines subject to these requirements.

All of the Company's pipelines located in federal offshore waters, whether subject to Natural Gas Act jurisdiction or exempted as nonjurisdictional gathering, are subject to the requirements of the Outer Continental Shelf Lands Act ("OCSLA"). FERC has stated that nonjurisdictional gathering lines, as well as interstate pipelines, are fully subject to the open access and nondiscrimination requirements of OCSLA's Section 5, which generally authorizes the FERC to insure that natural gas pipelines on the Outer Continental Shelf will transport for non-owner shippers in a nondiscriminatory manner and will be operated in accordance with certain pro-competitive principles. More recently, the FERC has undertaken several investigations into the nature and extent of its regulatory powers on the Outer Continental Shelf. It issued a policy statement on Outer Continental Shelf pipelines reaffirming the requirement that all pipelines provide nondiscriminatory service. Additionally, currently pending complaints against nonjurisdictional gathering facilities under the OCSLA seek more stringent FERC regulation of service and pricing.

Further FERC initiatives concerning possibly diminished Natural Gas Act regulation of pipelines on the OCS and/or broader regulation under the OCSLA are under consideration. Since all of the Companies' offshore pipelines already operate on the basis required under OCSLA, the Company does not anticipate significant changes directly resulting from requirements concerning nondiscriminatory open access transportation. Moreover, if an offshore pipeline's throughput increases to the extent that the pipeline's capacity is completely utilized, under OCSLA, the FERC may be petitioned to direct capacity allocation on the pipeline. Accordingly, the Company cannot predict how application of the OCSLA to the Companies' pipelines may ultimately affect Company operations.

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

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

FEDERAL REGULATION OF OIL PIPELINES. The Company's operation of the Buccaneer Pipeline is subject to a variety of regulations promulgated by the FERC and imposed on all oil pipelines pursuant to federal law. In particular, the rates chargeable by the Company are subject to prior approval by the FERC, as are operating conditions and related matters contained in the Company's transportation tariffs which are on file with the FERC. In October 1993, the FERC issued Order No. 561, which was intended to simplify oil pipeline ratemaking, largely through use of a ceiling based on an indexing system. Because Buccaneer Pipeline has not taken action to become subject to Order No. 561 or Order No. 572 concerning market-based rates for oil pipelines, the Company cannot predict whether or how an indexed or market-based rate system will affect the Buccaneer Pipeline's rates.

SAFETY AND OPERATIONAL REGULATIONS. The operations of the Company are generally subject to safety and operational regulations administered primarily by the MMS, the U.S. Department of Transportation, the U.S. Coast Guard, the FERC and/or various state agencies. Currently, the Company believes that it is in compliance with the various safety and operational regulations that it is subject to. However, as safety and operational regulations are frequently changed, the Company is unable to predict the future effect changes in these regulations will have on its operations, if any.

17

REGULATION OF DEEPWATER PORTS: PERMITTING AND LICENSING. The ownership, construction and operation of a deepwater crude oil terminal facility (a "Deepwater Port"), such as the Company's proposed Petroport facility, must conform to the requirements of a number of Federal, State and local laws. A license from the Department of Transportation ("DOT") is required under the Deepwater Port Act of 1974 ("DWPA"), as amended. Permits from the Environmental Protection Agency and the Federal Communication Commission are required, as well as permits from the U.S. Army Corps of Engineers and the State of Texas to construct ancillary port facilities, such as pipelines and onshore facilities.

The DWPA empowers the Secretary of Transportation to license and regulate Deepwater Ports beyond the territorial sea of the United States. License applications must include sufficient information to allow the Secretary of Transportation to judge whether a Deepwater Port will comply with all technical, environmental, and economic criteria. The application and licensing process includes the preparation of an Environmental Impact Statement, development of detailed operations procedures, submission of extensive financial and ownership data and public hearings.

The Company was a principal participant in the development and passage of The Deepwater Port Modernization Act in 1996, successfully amending the DWPA. The amendments to the Deepwater Port Act provide: (1) upon written request of an applicant for a license, the Secretary may exempt the applicant from certain of the informational filing requirements if the Secretary determines such information is not necessary to facilitate his or her determination and such exemption will not limit public review; (2) the facility is explicitly permitted to receive domestic production from the United States Outer Continental Shelf; (3) simplification and streamlining of the regulatory process to which the facility would be subject during both the licensing process and when in operation; and (4) elimination of various facility use restrictions. Once a license is issued, the law states that it remains in effect unless suspended or revoked by the Secretary of Transportation or is surrendered by the licensee.

Regulations provide for extensive consultation among all interested Federal agencies, any potentially affected coastal state, and the general public. Adjacent coastal states are granted an effective veto power or reservation over proposed Deepwater Ports. The Secretary of Transportation will not issue a

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

license without the approval of the governor of each adjacent coastal state. Under the statute, if a Governor of an adjacent coastal state notifies the Secretary of Transportation that a proposal is inconsistent with the state programs relating to environmental protection, land and water use, and coastal zone management, then the Secretary of Transportation shall grant the license on the condition that the proposal is made consistent with such state programs. Governors may, in their discretion, also reject proposed Deepwater Ports on other grounds.

In addition, the DWPA requires all Deepwater Ports, including related storage facilities, be operated as common carriers. As a common carrier the Company's proposed Petroport facility would be required to accept, transport or convey all oil delivered, unless it is subject to "effective competition" from alternative transportation systems.

Given the nature and complexity of obtaining the necessary license and permits, there can be no assurance that the Company will be issued a Deepwater Port license and other necessary permits.

FEDERAL OIL AND GAS LEASES. The Company's operations conducted on offshore oil and gas leases under the OCSLA must be conducted in accordance with permits issued by the MMS and are subject to a number of other regulatory restrictions similar to those imposed by the states.

With respect to any Company operations conducted on offshore federal leases liability may generally be imposed under OCSLA for costs of clean-up and damages caused by pollution resulting from such operations, other than damages caused by acts of war or the negligence of third parties. Under certain circumstances, including but not limited to conditions deemed a threat or harm to the

18

environment, the MMS may also require any Company operations on federal leases to be suspended or terminated in the affected area. Furthermore, the MMS generally requires that offshore facilities be dismantled and removed within one year after production ceases or the lease expires. However, on July 7, 2000, the MMS published proposed rules under which offshore structures may be left in place, subject to EPA approval. See "Oil and Gas Exploration and Production Activities - The Buccaneer Field."

ENVIRONMENTAL REGULATIONS. The Company may generally be liable for defined clean-up costs to the U.S. Government, with respect to its operations on both onshore and offshore properties, under the Federal Clean Water Act for each incident of oil or hazardous substance pollution and under the Comprehensive Environmental Response, Compensation and Liability Act of 1981, as amended ("Superfund"), for hazardous substance contamination. Such liability may be unlimited in cases of gross negligence or willful misconduct, and there is no limit on liability for environmental clean-up costs or damages with respect to claims by the states or by private persons or entities. In addition, the Environmental Protection Agency requires the Company to obtain permits to authorize the discharge of pollutants into navigable waters. State and local permits and/or approvals may also be needed with respect to wastewater discharges and air pollutant emissions. Violations of environmental related lease conditions or environmental permits can result in substantial civil and criminal penalties as well as potential court injunctions curtailing operations and the cancellation of leases. Such enforcement liabilities can result from either governmental or citizen prosecution.

LEGISLATION AND RULEMAKING. In October 1996 the U.S. Congress enacted the Coast Guard Authorization Act of 1996 (P.L. 104-324) which amended the Oil Pollution Act of 1990 ("OPA '90") to establish requirements for evidence of financial responsibility for certain offshore facilities, other than Deepwater

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

Ports. The amount required is \$35.0 million for certain types of offshore facilities located seaward of the seaward boundary of a state, including properties used for oil transportation. The Company currently maintains this statutory \$35.0 million coverage.

In August 1995, the DOT issued a Rulemaking under OPA '90, providing that the Secretary of Transportation can set the liability limit and associated Certificate of Financial Responsibility requirement for Deepwater Ports from between \$350.0 million and \$50.0 million concurrent with the overall processing of the DWP license application. Development of the liability limit would be based upon engineering and environmental analysis provided during the licensing process.

Federal and state legislative rules and regulations are pending that, if enacted, could significantly affect the oil and gas industry. It is impossible to predict which of those federal and state proposals and rules, if any, will be adopted and what effect, if any, they would have on the operations of the Company.

In addition, various federal, state and local laws and regulations covering the discharge of materials into the environment, occupational health and safety issues, or otherwise relating to the protection of public health and the environment, may affect the Company's operations, expenses and costs. The trend in such regulation has been to place more restrictions and limitations on activities that may impact the general or work environment, such as emissions of pollutants, generation and disposal of wastes, and use and handling of chemical substances. It is not anticipated that, in response to such regulation, the Company will be required in the near future to expend amounts that are material relative to its total capital structure. However, it is possible that the costs of compliance with environmental and health and safety laws and regulations will continue to increase. Given the frequent changes made to environmental and health and safety regulations and laws, the Company is unable to predict the ultimate cost of compliance.

19

GLOSSARY OF CERTAIN OIL AND GAS TERMS

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

BBL. One stock tank barrel, or 42 U.S. gallons liquid volume, used in reference to oil or other liquid hydrocarbon.

BCF. One billion cubic feet of natural gas.

BTU OR BRITISH THERMAL UNIT. The quantity of heat required to raise the temperature of one pound of water by one degree Fahrenheit.

CONDENSATE. Liquid hydrocarbons associated with the production of a primarily natural gas reserve.

DEVELOPMENT WELL. A well drilled into a proved natural gas or oil reservoir to the depth of a stratigraphic horizon known to be productive.

EXPLORATORY WELL. A well drilled to find and produce natural gas or oil reserves that are not proved, to find a new reservoir in a field previously found to be productive of natural gas or oil in another reservoir or to extend a known reservoir.

FIELD. An area consisting of a single reservoir or multiple reservoirs all grouped on or related to the same individual geological structural feature

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

and/or stratigraphic level.

LEASE BLOCK. Refers to several leases within close proximity of one another.

LEASEHOLD INTEREST. The interest of a lessee under an oil and gas lease.

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

MCF. One thousand cubic feet of natural gas.

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

MMBTU. One million British Thermal Units.

MMCF. One million cubic feet of natural gas.

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

NET REVENUE INTEREST. A share of a working interest that is not required to continue to, nor liable for, any portion of the expense of drilling and completing the well.

NONOPERATING WORKING INTEREST. A working interest, or a fraction of a working interest, in a tract where the owner does have operating rights.

OVERRIDING ROYALTY. An interest in oil and gas produced at the surface, free of the expense of production and in addition to the usual royalty reserved to the lessor in an oil and gas lease.

20

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

PROVED DEVELOPED RESERVES. Those quantities of oil, natural gas and condensate that can be expected to be recovered through existing wells with existing equipment and operating methods.

PROVED RESERVES. The estimated quantities of oil, natural gas and condensate that geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions.

PROVED UNDEVELOPED RESERVES. Reserves that are expected to be recovered from new wells on developed acreage where the subject reserves cannot be recovered without drilling additional wells.

REVERSIONARY INTEREST. A form of ownership interest in property that reverts back to the transferor after expiration of an intervening income interest.

ROYALTY INTEREST. An interest in a natural gas and oil property entitling the owner to a share of natural gas and oil production free of costs of production.

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

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

WORKING INTEREST. The operating interest that gives the owner the right to drill, produce and conduct operating activities on the property and receive a share of production.

ITEM 2. PROPERTIES

Information appearing in Item 1 describing the Company's oil and gas properties under the caption "Business and Properties" is incorporated herein by reference.

The Company leases its executive offices in Houston, Texas, under an operating lease expiring December 31, 2006. The Company also leases under an operating lease, its division office in New Orleans, Louisiana. The lease has been extended from April 30, 2000 to April 30, 2002. The Company's aggregate annual lease payment obligations under these leases are \$190,211.

ITEM 3. LEGAL PROCEEDINGS

On May 8, 2000, American Resources, a 75% 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 natural gas purchase options and natural 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 natural 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 Gas is seeking approximately \$5.65 million in actual damages, treble damages, punitive damages, prejudgment interest and attorneys' fees. American Resources intends to vigorously defend this claim.

21

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

The Company did not submit any matter to a vote of security holders during the quarter ended December 31, 1999.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON STOCK AND RELATED STOCKHOLDER MATTERS

The Company's common stock trades in the over-the-counter market and is quoted on the NASDAQ Small Cap Market under the symbol "BDCO". As of November 8, 2000, there were an estimated 325 stockholders of record and the Company estimates there are more than 1,000 beneficial owners of its common stock. NASDAQ quotations reflect inter-dealer prices, without adjustment for retail mark-ups, markdowns or commissions and may not represent actual transactions. The following table sets forth, for the periods indicated, the high and low sales price for the common stock as reported on NASDAQ.

| SALES | |
|-------|-------|
| HIGH | LOW |
| ----- | ----- |

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

| | | |
|--|---------|---------|
| Quarter Ended March 31, 1998 | \$ 4.50 | \$ 2.75 |
| Quarter Ended June 30, 1998 | \$ 3.69 | \$ 3.13 |
| Quarter Ended September 30, 1998 | \$ 3.56 | \$ 2.44 |
| Quarter Ended December 31, 1998 | \$ 3.50 | \$ 2.63 |
| Quarter Ended March 31, 1999 | \$ 4.69 | \$ 3.13 |
| Quarter Ended June 30, 1999 | \$ 6.00 | \$ 4.00 |
| Quarter Ended September 30, 1999 | \$ 6.88 | \$ 5.00 |
| Quarter Ended December 31, 1999 | \$ 7.94 | \$ 5.75 |

The Company currently intends to retain earnings for its capital needs and expansion of its business and does not anticipate paying cash dividends on the common stock in the foreseeable future. Previously, the Company was restricted, pursuant to its loan agreement from paying dividends on the common stock if there was an outstanding balance under the loan agreement. Future policy with respect to dividends will be determined by the Board of Directors based upon the Company's earnings and financial condition, capital requirements and other considerations. The Company is a holding company that conducts substantially all of its operations through its subsidiaries. As a result, the Company's ability to pay dividends on the common stock is dependent on the cash flow of its subsidiaries. The Company has not declared or paid any dividends on the common stock since its incorporation.

RECENT SALES OF UNREGISTERED SECURITIES. During the year ended December 31, 1999, Directors, Officers and other employees exercised options to purchase 32,004 shares of common stock. The sale of shares was privately made to Directors, Officers and other employees pursuant to the Company's 1985 and 1996 Stock Option Plans, at exercise prices between \$2.7885 and \$4.383 per share. The Company relied on an exemption under Section 4(2) of the Securities Act of 1933 in effecting these transactions.

In June 1999, the Company received \$1,960,000 through a private placement of 392,000 shares of its' common stock at \$5.00 per share. The proceeds were used to replenish working capital.

In order to provide funding for the acquisition of American Resources in December 1999, the Company arranged a private placement and conversion of principal and accrued interest on promissory notes into common stock, \$.01 par value per share, of 701,820 shares and 314,898 shares, respectively. The shares were issued at a price of \$6.00 per share. Consideration for the common stock sold consisted of approximately \$4,210,919 cash and the surrender of approximately \$1,811,555

22

of the Company's promissory notes due December 31, 2000, along with accrued interest of \$77,835 through December 1, 1999.

ITEM 6. SELECTED FINANCIAL DATA

The selected financial data of the Company and its consolidated subsidiaries is presented for the five fiscal years ended December 31, 1999. Such information should be read with Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the Consolidated Financial Statements of the Company and the related Notes included elsewhere in this report.

| YEAR ENDED DECEMBER 31, | | | |
|-------------------------|------|------|------|
| 1999 | 1998 | 1997 | 1996 |

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

| | | | | |
|--|--------------------|--------------------|---------------|---------------|
| Operating Revenues | \$ 2,757,056 | \$ 3,558,773 | \$ 4,982,606 | \$ 4,128,568 |
| Income (loss) from Continuing operations | \$ (2,086,511) | \$ (9,059,979) (4) | \$ 983,095 | \$ 92,302 |
| Income (loss) from Continuing operations per Common Share (1) (3) . | \$ (0.43) | \$ (2.02) | \$.22 | \$ (.06) |
| Weighted average number of Common Shares (3) | 4,837,504 | 4,492,344 | 4,462,072 | 3,107,026 |
| Income (loss) from continuing Operations per diluted Common Share(1) (3) | \$ (0.43) | \$ (2.02) | \$.22 | \$ (.06) |
| Weighted average number of Common Shares and dilutive Potential Common Shares Outstanding (3) | 4,837,504 | 4,492,344 | 4,531,208 | 3,107,026 |
| Net Income (loss) | \$ (2,086,511) (5) | \$ (9,059,979) (4) | \$ 983,095 | \$ 92,302 |
| Working Capital | \$ 93,231 | \$ 310,543 | \$ 1,856,333 | \$ 917,113 |
| Total Assets | \$ 21,538,216 | \$ 14,867,216 | \$ 24,644,387 | \$ 23,428,426 |
| Long-term debt | -- | \$ 2,060,600 | \$ 2,060,600 | \$ 2,060,600 |

- (1) Income from continuing operations per Common Share and dilutive Common Share in 1999, 1998, 1997, 1996 and 1995 is based on the weighted average number of Common Shares outstanding.
- (2) Includes the gain on the sale of a one-third interest in the Blue Dolphin Pipeline System effective August 1, 1995.
- (3) The weighted average number of Common Shares and potential Common Shares outstanding for the years ended December 31, 1996 and 1995, have been restated to reflect the one-for-fifteen reverse stock split effected on December 8, 1997.
- (4) Includes a non-cash impairment of oil and gas properties effective December 31, 1998.
- (5) Includes the gain on the sale of a one-sixth interest in the Blue Dolphin Pipeline System effective March 1, 1999, and a non-cash valuation allowance of its deferred tax assets.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

23

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 Consolidated Financial Statements included in Item 8 and incorporated herein by reference, and Item 1. Business and Properties.

FINANCIAL CONDITION: LIQUIDITY AND CAPITAL RESOURCES

The following table summarizes our financial position at December 31, 1999

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

and 1998 (amounts in thousands):

| | DECEMBER 31, 1999 | | DECEMBER 31, 1998 | |
|-----------------------------------|-------------------|-------|-------------------|-------|
| | AMOUNT | % | AMOUNT | % |
| Working Capital | 93 | -- | 311 | 2 |
| Property and equipment, net | 15,195 | 82 | 8,627 | 63 |
| Other noncurrent assets | 3,316 | 18 | 4,718 | 35 |
| | ----- | ----- | ----- | ----- |
| Total | 18,604 | 100 | 13,656 | 100 |
| | ===== | ===== | ===== | ===== |
| Long-term debt | -- | -- | 2,061 | 15 |
| Minority Interest | 958 | 5 | -- | -- |
| Shareholders' equity | 17,646 | 95 | 11,595 | 85 |
| | ----- | ----- | ----- | ----- |
| Total | 18,604 | 100 | 13,656 | 100 |
| | ===== | ===== | ===== | ===== |

The significant changes in our financial position from December 31, 1998 to December 31, 1999 are the increase in property and equipment of \$7.2 million and the increase in stockholders' equity of \$6.1 million. The increase in property and equipment was due to the acquisition of the Black Marlin Pipeline Company and American Resources. The increase in stockholders' equity was due to private placements of common stock, offset in part by the Company's 1999 net loss of \$2.1 million.

Historically, the Company has primarily relied on the proceeds from financing activities to supplement its capital requirements. In 1999, the Company financed its activities through a combination of private equity and debt financing and sale of assets. 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 and private equity or debt financing activities 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):

| | YEARS ENDING DECEMBER 31 | | |
|---------------------------------------|--------------------------|---------|-------|
| | 1999 | 1998 | 1997 |
| Net cash provided by (used in): | | | |
| Operating activities | (1,087) | 397 | 1,435 |
| Investing activities | (5,458) | (1,791) | (926) |
| Financing activities | 7,118 | 231 | 40 |
| | ----- | ----- | ----- |
| Net increase (decrease) in cash | 573 | (1,163) | 549 |
| | ===== | ===== | ===== |

The Company's cash flows from operating activities decreased \$1.5 million in 1999 from 1998, due primarily to a decline in oil and gas volumes transported by the Blue Dolphin System. Cash flow from operating activities decreased by \$1.0 million in 1998 from 1997, also due primarily to a decline in oil and gas volumes transported by the Blue Dolphin System. The Blue Dolphin System is dependent upon drilling and development activity in its vicinity which have been very limited during 1998 and 1999.

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

Cash flow used in investing activities in 1999 primarily included capital expenditures for the 50% ownership interest in the Black Marlin Pipeline of \$2.7 million and the 75% ownership interest in American Resources of \$4.5 million (see Note 12 in Item 8. Financial Statements). Cash flow used in investing activities in 1998 included the unreimbursed costs of the oil and gas prospect generation program of \$.7 million and development costs of Petroport of \$.8 million. Cash flow used in investing activities in 1997 primarily included plugging and abandonment costs of a well in the Buccaneer Field of \$.6 million and funds escrowed for future abandonment costs of \$400,000.

Cash flow provided by financing activities in 1999 consisted of net proceeds from a private placement of common stock of \$6.2 million and debt of \$1.0 million. The Company expects to continue to seek external financing to meet its liquidity requirements. Cash flow provided by funding activities in 1998 and 1997 were minimal.

The Company issued three convertible promissory notes in 2000 totaling \$1.0 million; 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 \$0.6 million on November 30, 2000, issued to TI A/S, beneficially controlled by Ivar Siem. These convertible promissory notes are due March 31, 2001, bear interest at the rate of 10% per annum and are convertible into common stock at the rate of \$6.00 per share.

The Company entered into an agreement with Fidelity Oil to manage their interest in the properties acquired from American Resources for \$40,000 per month. This amount is intended to reimburse the Company for its cost of services provided. As of December 31, 2000 the Company has received \$480,000 in management fees pursuant to this agreement. The agreement expires in December 2000 and provides for continuation thereafter on a year to year basis unless terminated by either party or extended by Fidelity Oil. Fidelity Oil has notified the Company that it is electing to continue the agreement on a month to month basis, and has indicated that it may terminate this agreement at January 31, 2001. The Company is presently discussing extending this agreement beyond January 31, 2001 with Fidelity Oil, however there can be no assurance that the Company will be able to reach an agreement with Fidelity Oil for the extension of this agreement beyond January 31, 2001.

In order to provide funding for the acquisition of American Resources in December 1999, the Company arranged a private placement of 701,820 shares of common stock and conversion of principal and accrued interest on promissory notes into 314,898 shares of common stock. Two members and one former member of the board of directors participated in this private placement. Daniel B. Porter, a former director of the Company, (i) paid \$100,000 for 16,667 shares of common stock and (ii) paid \$325 and tendered a note and accrued interest totaling \$99,875 for an additional 16,700 shares. Additionally, Harris A. Kaffie, a director of the company, paid \$149 and tendered a note and accrued interest totaling \$187,651 for 31,300 shares of common stock and Ivar Siem, Chairman of the Board of Directors, paid \$281 and tendered a note and accrued interest totaling \$27,919 for 4,700 shares. (See Notes 5 and 7 in Item 8, Financial Statements and Supplementary Data). The Company also issued a \$1.0 million convertible promissory note to Harris A. Kaffie, a director of the Company. The note originally due June 1, 2000, has been extended to March 31, 2001, bears interest at 10% per annum and can be converted into common stock at \$6.00 per share. The Company believes that if the \$1.0 million convertible promissory note is not converted, the amount due will be refinanced.

In June 1999, the Company received \$1.96 million through a private placement of 392,000 shares of its common stock, \$.01 par value per share, at \$5.00 per share. The proceeds were used to replenish working capital.

The Company maintained a \$10.0 million reducing revolving credit facility with Bank One, Texas, N.A. (the "Loan Agreement") that expired on December 31, 2000. The facility was available for the acquisition of oil and gas reserve based assets and working capital. The maximum amount the Company was able to borrow under the Loan Agreement was \$6.5 million. In January 2000, the Company paid the \$80,000 outstanding balance under the Loan Agreement and its borrowing capacity under the Loan Agreement was adjusted to \$0. At December 31, 2000 the Company did not have an outstanding balance under the Loan Agreement.

The bank redetermined the borrowing base semi-annually based on its valuation of the Company's oil and gas properties and pipeline contracts. Accordingly, the bank could increase the borrowing base under the Loan Agreement to \$10.0 million, the maximum amount the Company could borrow under the Loan Agreement, or some lesser amount based upon the bank's valuation of these assets. The Loan Agreement included certain restrictive covenants that are applicable if any amounts were outstanding under the agreement, including restrictions on the Company's ability to pay dividends on its capital stock and the maintenance of certain financial ratios. Certain of the various financial covenants the Company was required to comply with, included maintaining (i) a total tangible net worth of \$10.25 million, (ii) a debt coverage ratio of not less than 1.2 to 1 calculated on a rolling four-quarter basis and (iii) a current ratio (as defined in the Loan Agreement) of at least 1 to 1.

In July 2000, the Company executed an agreement to provide transportation services for Vastar Resources in High Island Block A-5 offshore Texas in the Gulf of Mexico. To accommodate this production, the Company agreed to construct a 3.4 mile 12" diameter pipeline from the production platform in High Island A-5 to the Black Marlin Pipeline. The cost to construct the pipeline was \$2.0 million, \$1.0 million net to the Company's 50% interest in the pipeline. The pipeline was completed in September 2000. Full operations are expected to commence in February 2001. The Company financed this pipeline with the convertible promissory notes issued in 2000.

In July 2000, production from the only producing well in the Buccaneer Field, the A-12 well, ceased due to down-hole mechanical problems. The Company retained an outside consultant to advise it concerning the best method to restore production from the well. Among the various alternatives being considered were: drilling a new vertical well; sidetracking; conducting a workover; drilling a new horizontal well; and sidetracking the A-12 well horizontally. The consultant concluded that the drilling of a new well, estimated to cost \$2.8 million, was the best technical solution to restoring production because of the age and condition of the A-12 well bore. Based on his opinion that the most likely rate that the new well could be expected to produce at was 1,000 Mcf per day and that a positive discounted cash flow from the well could not be achieved unless a daily production rate of 1,500 Mcf per day or more was experienced, the consultant recommended that the Company should not drill the new well. Furthermore, the consultant advised the Company that he did not feel that the possible returns from the new well justified the risks involved and recommended the abandonment of the Buccaneer Field. Based on this recommendation the Company chose not to attempt to restore production to the A-12 well or redrill.

In early October 2000, as a result of a routine inspection by the MMS of the two major platform complexes in the field, the MMS dictated that certain repairs to the platforms must be made before the Company could resume operating activities in the Buccaneer Field. The Company estimates the cost of these required, unplanned repairs to be in excess of \$1.0 million. The Company estimates that if it had chosen to pursue restoration of production in the field the actual infrastructure cost to do so would have been \$2.6 million, including an estimated \$.6 million to repair one of the platform complexes. Thus, the cost

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

to reestablish production would have increased to an estimated \$5.4 million, consisting of \$2.6 million in front-end infrastructure costs and \$2.8 million in drilling costs. Instead of making this expenditure and thereafter continue to incur ongoing operating costs, the Company elected to abandon the Buccaneer Field.

26

The Company reached an agreement, with Tetra Applied Technologies, Inc. ("Tetra") to plug and abandon the wells and remove its facilities located in the Buccaneer Field. Tetra will plug and abandon the remaining ten wells in the Buccaneer Field and remove the platforms and attached quarters platforms in Galveston Area Blocks 288 and 296. In addition, Maritech Resources, Inc. ("Maritech") an affiliate of Tetra has purchased an adjacent lease on which the Company provided operation services to Apache Corporation. 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 will be installed to operate and maintain the Blue Dolphin System, as well as handle the production from Maritech's lease. The Blue Dolphin System is currently attached to and operated from the Buccaneer Field platforms. The Company believes that the installation of the new platform is the best alternative to continue to operate and maintain the Blue Dolphin System. The platform is expected to be installed by the end of the first quarter of 2001, at an estimated cost of \$1.5 million net to the Company's interest in the Blue Dolphin System. Plugging and abandonment of the Buccaneer Field wells is expected to begin in the first quarter of 2001. It is estimated that the plugging and abandonment costs will be \$1.0 million. The removal of the Buccaneer Field platform facilities is expected to begin in the second half of 2001, at an estimated cost of \$4.3 million.

The Company will partially finance the well plugging and abandonment and the removal of the Buccaneer Field platform facilities totaling \$5.3 million, by using its sinking fund for abandonment obligations of approximately \$1.49 million. The Company expects to finance the remaining expenses, and install a new Blue Dolphin System platform through the sale of assets and/or the private placement of debt or equity securities.

In July 2000, the Company acquired an 83.3% ownership interest in an 8-inch, 12.78-mile pipeline from Walter Oil and Gas Corp. for approximately \$224,077. The pipeline extends from Galveston Area Block 350 to an interconnect to another pipeline in Galveston Area Block 391, approximately 14 miles south of the Company's Blue Dolphin Pipeline. The pipeline currently transports nominal volumes of gas, but the Company believes it is well positioned to attract future discoveries in the area.

In June 1999, the Company removed an inactive satellite platform in the Buccaneer Field at a cost of approximately \$345,000. The Company's annual abandonment escrow fund payment of \$250,000 that was due in June 1999 was waived pursuant to a verbal agreement with the MMS as a result of the removal of the inactive satellite platform.

The reserves and future net revenues presented in Item 1 "Business - Oil and Gas Exploration and Production Activities," reflect capital expenditures totaling \$1,416,323, \$570,139, \$404,430, \$178,350 and \$43,300 in the years ending December 31, 2000, 2001, 2002, 2003 and 2004, respectively. 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.

In 1999 the Company placed a 50% interest in the prospect generation

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

program, whereby in exchange for certain participation rights, the participant funds \$100,000 per month for the costs associated with the program. Program costs will be reimbursed to the Company as prospects are developed and leases acquired. A portion of the reimbursed costs will be paid to the Company's existing program participant based on the level of interest it retains in each prospect. During 1999, the Company sold one prospect and retained a reversionary interest in the prospect. The available interests in the prospect inventory are for sale on an individual prospect basis. A well is currently being drilled on a prospect the Company previously sold in which it has retained a reversionary interest. The Company had previously entered into a multi-year 3-D seismic data acquisition and licensing agreement, whereby a minimum of \$1.5 million was committed over a 5 year period that ended

27

July 31, 1999 to acquire 3-D seismic data. The final commitment under the agreement, \$450,000, was paid in July 1999.

In April 2000, the Company amended its prospect generation program agreement with Fidelity Oil, whereby in exchange for certain participation rights of up to 100%, Fidelity Oil will fund \$1.06 million of the costs associated with the program during 2000. Fidelity Oil will also reimburse the Company for seismic data acquired. The available interest in the prospect inventory developed in the program are for sale on an individual prospect basis. Fidelity Oil withdrew from the prospect generation program December 31, 2000. If funding from another company is not arranged, the Company may terminate its prospect generation program.

In November 1999, the Company and WBI Holdings formed New Avoca, 25% owned and managed by the Company and 75% owned by WBI Holdings, and acquired the Avoca gas storage assets for \$400,000 (\$100,000 net to the Company's interest) from Northeastern. Additionally, a contingent payment of \$0.5 million (\$125,000 net to the Company's interest) was due to Northeastern on May 22, 2000. New Avoca made a payment of \$50,000 and extended the remaining \$450,000 payment to August 22, 2000. In August 2000, Northeastern extended the contingent payment until October 2000 in exchange for increasing the contingent payment by \$10,000 to \$460,000. The contingent payment would be excused, and the \$40,000 net payment made would be refunded, if Northeastern successfully settles a claim associated with Avoca Gas Storage, Inc. (the original owner of the Avoca gas storage assets). In October 2000, Northeastern received a payment on its claim and refunded the \$40,000 previously paid by New Avoca. New Avoca can elect to liquidate the project at any time.

New Avoca completed an analysis of the project. Based on this analysis and recent technological advances, New Avoca believes the disposal wells will be capable of handling the more moderate rates of brine injection expected to be produced under its proposed construction schedule. In October 2000, New Avoca commenced testing of the disposal wells to determine the rate that these wells will accept brine. Based on the results of the tests, New Avoca expects to make a decision to either proceed with or liquidate the project. If liquidated, the Company believes that it can recover its investment in this project. If the decision is made to proceed with the project, New Avoca estimates that it will take between one and one-half to two years to begin operations at partial capacity, and three to four years for the facility to operate at full capacity. However, until the Company has reviewed and analyzed the results from the tests of the disposal wells it will be unable to establish a definitive schedule or accurately estimate the costs to complete this project.

Although the Loan Agreement expired in December 2000 and prior to its expiration the borrowing base under the Loan Agreement was \$0, 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 capital

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

requirements have been financed by the disposition of certain assets, for example interests in its pipelines, by borrowings under the Loan Agreement, 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 reasonable terms. The Company's inability to finance its capital requirements 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

For the year ended December 31, 1999 ("1999"), the Company reported a net loss of \$2,086,511, compared to net loss of \$9,059,979 reported for the year ended December 31, 1998 ("1998"), representing an improvement of \$6,973,468. The improvement is primarily due to a non-cash impairment of oil and gas properties recorded at December 31, 1998 of \$8,952,785, net of

28

income tax benefit, offset in part by a non-cash valuation allowance on its deferred tax assets of \$1,858,608 recorded at December 31, 1999.

For the year ended December 31, 1998 ("1998"), the Company reported a net loss of \$9,059,979, compared to net income of \$983,095 reported for the year ended December 31, 1997 ("1997"), representing a decrease of \$10,043,074. The decrease is primarily due to the non-cash impairment of oil and gas properties recorded at December 31, 1998 of \$8,952,785, net of income tax benefit.

1999 COMPARED TO 1998

REVENUE FROM PIPELINE OPERATIONS. Pipeline system revenues decreased by \$913,228 or 33% in 1999 to \$1,875,716 from 1998. The decrease was due to a decline in gas and oil volumes transported by the Blue Dolphin System of approximately \$1,424,749, and the sale of a one-sixth interest in the Blue Dolphin System in March 1999, eliminating revenues of \$189,623, offset in part by the acquisition of the Black Marlin System, providing revenues of \$701,144.

REVENUE FROM OIL AND GAS SALES AND OPERATING FEES. Oil and gas sales and operating fees increased by \$111,511 or 15% in 1999 to \$881,340 from 1998. The acquisition of American Resources in December 1999 provided revenues of \$307,195, partially offset by a reduction in Buccaneer Field revenues of \$195,684 or 25%. Although commodity prices in general increased during 1999, gas sales from the Buccaneer Field were based on a fixed price of \$2.08 per MMBtu through September 1999. Since October 1999, the price received for Buccaneer Field gas production has been based on the current monthly market price.

PIPELINE OPERATING EXPENSES. Pipeline operating expenses increased \$218,946 or 25% to \$1,102,998 from 1998. The increase was due to the acquisition of the Black Marlin System in March 1999, with expenses of \$393,696 in 1999, offset in part by the sale of a one-sixth interest in the Blue Dolphin System in March 1999, eliminating expenses of \$108,205, and cost reductions from continuing operations of \$66,545.

LEASE OPERATING EXPENSES. Lease operating expenses increased by \$254,450 or 30% in 1999 to \$1,100,549 from 1998. The increase was due primarily to costs of approximately \$187,738 associated with repairs made to the offshore platforms in the Buccaneer Field in 1999 and approximately \$66,712 associated with the American Resources properties that were acquired in December 1999.

DEPLETION, DEPRECIATION AND AMORTIZATION ("DD&A"). DD&A expense increased by \$194,304 or 48% in 1999 to \$595,286 from 1998. The increase was due to the

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

acquisition of the Black Marlin System in March 1999, resulting in depreciation of approximately \$199,017, and American Resources in December 1999, resulting in depletion of approximately \$124,562. These increases were partially offset by a reduction in depletion due to lower production volumes from the Buccaneer Field of approximately \$92,475, and the sale of a one-sixth interest in the Blue Dolphin System in March 1999, resulting in a \$36,800 reduction in depreciation.

GENERAL AND ADMINISTRATIVE EXPENSES. General and administrative expenses increased \$595,067 or 41% to \$2,061,805 from 1998. The increase was primarily due to increased personnel costs associated with the Company's asset acquisitions during 1999. The Company expects to maintain this higher level of general and administrative expenses.

GAIN ON SALE OF ASSETS. In March 1999, the Company reported a gain on the sale of a one-sixth interest in the Blue Dolphin System of approximately \$2,052,920.

29

INCOME TAX EXPENSE. In 1999 the Company recorded a valuation allowance of its deferred tax assets in accordance with SFAS No. 109 Accounting for Income Taxes, whereby the deferred tax asset of \$2,103,052 was reduced to \$244,444, resulting in an increase in income tax expense of \$1,858,608.

1998 COMPARED TO 1997

REVENUE FROM PIPELINE OPERATIONS. Pipeline system revenues decreased by \$1,373,649 or 33% in 1998 to \$2,788,944 from 1997. The decrease was due to a decrease in oil transportation revenues of \$1,120,457, primarily due to the loss of a producer/shipper in October 1997.

REVENUE FROM OIL AND GAS SALES AND OPERATING FEES. Revenues from oil and gas sales and operating fees for 1998 decreased \$50,184 or 6% to \$769,829 from 1997. The reduction in oil and gas sales is attributable to normal production declines from the Buccaneer Field.

INTEREST AND OTHER INCOME. Other income for 1998 decreased \$157,432 or 40% to \$105,994 from 1997. The reduction in other income is due to a refund of prior years franchise taxes of \$152,370 received in 1997.

LEASE OPERATING EXPENSES. Lease operating expenses for 1998 decreased by \$29,472 to \$846,099 from 1997 due in part to repairs and modifications to the Buccaneer Field production platforms and facilities of approximately \$68,000 incurred in 1997.

GENERAL AND ADMINISTRATIVE EXPENSES. General and administrative expense increased by \$108,967 or 8% in 1998 from 1997 principally due to an increase in personnel costs and consulting fees of approximately \$95,472, associated with potential asset acquisitions.

IMPAIRMENT OF OIL AND GAS PROPERTIES. Under the full cost accounting rules, the Company reviews the carrying value of its proved oil and gas properties quarterly. Under these rules capitalized costs of proved oil and gas properties, net of accumulated depreciation, depletion and amortization may not exceed the present value of estimated future net cash flows from proved oil and gas reserves, discounted at 10 percent, plus the lower of cost or fair value of unproved properties included in the costs being amortized, net of related tax effects. These rules generally require pricing future oil and gas production at the unescalated oil and gas prices in effect at the end of the period and require a write-down if the "ceiling" is exceeded. At December 31, 1998, the Company recorded a non-cash impairment charge of \$12,011,544, reflecting the write down of its oil and gas properties and certain exploration activity costs.

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

The non-cash impairment of oil and gas properties resulted from a 15% decrease in the price of gas and a 35% decrease in the price of oil used to value the Company's reserves from the prior period, as well as changes to the Company's development plans, whereby development of the Buccaneer Field reserves have been delayed.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

Statement of Financial Standards No. 133, Accounting for Derivative Instruments and Hedging Activities ("SFAS No. 133"), was issued by the Financial Accounting Standards Board in June 1998. SFAS No. 133 standardizes the accounting for derivative instruments, including certain derivative instruments embedded in other contracts. In July 1999, SFAS NO. 137, "Deferral of the Effective Date of SFAS No. 133," was issued and delays the effective date for one year, to fiscal years beginning after June 15, 2000. The Company is evaluating the impact of the provisions of SFAS No. 133.

In April 1998, the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants issued Statement of Position 98-5, Reporting on the Costs of Start-Up Activities ("SOP 98-5"). SOP 98-5 requires that costs of start-up activities be charged to expense as

30

incurred and broadly defines such costs. The Company has capitalized certain costs incurred in connection with a new business segment, and SOP 98-5 requires that such costs be charged to results of operations upon its adoption. The Company adopted the requirements of SOP 98-5 as of January 1, 1999 resulting in a cumulative effect of a change in an accounting principle of \$80,334, net of income tax benefit of \$41,480.

YEAR 2000 ISSUE

The Company's computer software was made Year 2000 compliant prior to the end of 1999; and, therefore, the business, results of operations and financial condition of the Company were not affected by the millennium change.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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. Except as discussed below, the Company has not used derivative products in the past to manage commodity price risk.

INTEREST RATE RISK: The Company's exposure to changes in interest rates primarily results from its short-term and long-term debt with floating interest rates. Since the Company does not have an outstanding balance under the Loan Agreement a 10% change in the interest rate on the credit facility would not effect interest expense.

DERIVATIVES: In October 1999, American Resources sold call options for 5 MMBtu's per day of gas at a call price of \$3.25 per MMBtu to H & N Gas. The call options expire in September 2000. In exchange for establishing a ceiling of \$3.25 per MMBtu over the option term, American Resources received an average option premium of approximately \$0.12 per MMBtu on the volumes contracted for under the call option agreement. Fidelity Oil agreed to assume 80%, or 4 MMBtu's per day, of any liability from these options. The call options are settled each month. The months of October 1999 through May 2000 expired with no liability to

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

American Resources. The liability from the June 2000 option was \$147,900, of which Fidelity Oil reimbursed American Resources \$118,320. For the months of July and August 2000, the settlement amounts were \$222,580 and \$79,515, respectively, of which Fidelity Oil has reimbursed American Resources \$178,064 and \$63,612, respectively.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

| Index to Financial Statements: | PAGE |
|--|------|
| Independent Auditors' Report..... | 32 |
| Consolidated Balance Sheets, at December 31, 1999 and 1998.... | 34 |
| Consolidated Statements of Operations, for the years ended December 31, 1999, 1998, and 1997..... | 36 |
| Consolidated Statements of Stockholders' Equity, for the years ended December 31, 1999, 1998, and 1997..... | 37 |
| Consolidated Statements of Cash Flows, for the years ended December 31, 1999, 1998, and 1997..... | 38 |
| Notes to Consolidated Financial Statements..... | 40 |

31

INDEPENDENT AUDITORS' REPORT

The Board of Directors
Blue Dolphin Energy Company:

We have audited the accompanying consolidated balance sheets of Blue Dolphin Energy Company and subsidiaries as of December 31, 1999 and 1998, and the related consolidated statements of operations, stockholders' equity and cash flows for each of the years in the three-year period ended December 31, 1999. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the consolidated financial statements of American Resources Offshore, Inc., a 75 percent owned subsidiary, which statements reflect total assets constituting 6 percent and total revenues constituting 11 percent in 1999 of the related consolidated totals. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for American Resources Offshore, Inc., is based solely on the report of the other auditors.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Blue Dolphin Energy Company and subsidiaries as of December 31, 1999 and 1998, and the results of its their operations and their cash flows for each of the years in the three-year period ended December 31, 1999 in conformity with generally accepted accounting

principles.

/s/ KPMG LLP

Houston, Texas
March 28, 2000

32

Independent Auditors' Report

The Board of Directors and Shareholders
American Resources Offshore, Inc.

We have audited the accompanying consolidated balance sheets of American Resources Offshore, Inc. as of December 31, 1999 and 1998, and the related consolidated statements of operations, stockholders' equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion of these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of American Resources Offshore, Inc. as of December 31, 1999 and 1998, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

/s/ Ernst & Young LLP

New Orleans, Louisiana
March 10, 2000

33

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

December 31, 1999 and 1998

| ASSETS | 1999 | 1998 |
|---|--------------|---------|
| | ----- | ----- |
| Current assets: | | |
| Cash and cash equivalents | \$ 1,166,730 | 593,509 |
| Trade accounts receivable | 1,542,328 | 771,268 |
| Prepaid expenses and other assets | 318,139 | 157,588 |
| | ----- | ----- |

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

| | | |
|--|--------------|------------|
| Total current assets | 3,027,197 | 1,522,365 |
| | ----- | ----- |
| Property and equipment, at cost: | | |
| Oil and gas properties, including \$950,813 and \$227,286 of unproved leasehold cost at December 31, 1999 and 1998, respectively (full-cost method) | 26,474,957 | 21,210,806 |
| Onshore separation and handling facilities ... | 1,583,610 | 2,106,189 |
| Land | 930,500 | 1,133,333 |
| Pipelines | 3,653,397 | 1,320,063 |
| Other property and equipment | 431,294 | 343,220 |
| | ----- | ----- |
| | 33,073,758 | 26,113,611 |
| Less accumulated depletion, depreciation, amortization and impairment | 17,879,183 | 17,486,651 |
| | ----- | ----- |
| | 15,194,575 | 8,626,960 |
| Deferred federal income tax | 244,444 | 2,010,060 |
| Acquisition and development costs - Petroport ... | 1,741,823 | 1,576,391 |
| Escrow fund | 1,168,564 | 1,107,573 |
| Other assets | 161,613 | 23,867 |
| | ----- | ----- |
| | \$21,538,216 | 14,867,216 |
| | ===== | ===== |

See accompanying notes to consolidated financial statements.

(Continued)

34

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS, CONTINUED

December 31, 1999 and 1998

| LIABILITIES AND STOCKHOLDERS' EQUITY | 1999 | 1998 |
|---|--------------|-----------|
| | ----- | ----- |
| Current liabilities: | | |
| Trade accounts payable and accrued expenses | \$ 1,347,944 | 892,190 |
| Current portion of long term debt | 319,045 | 200,000 |
| Note payable - related party | 1,000,000 | -- |
| Accrued expenses and other liabilities | 266,977 | 119,632 |
| | ----- | ----- |
| Total current liabilities | 2,933,966 | 1,211,822 |
| | ----- | ----- |
| Long-term debt | -- | 2,060,600 |
| | ----- | ----- |
| Total long-term liabilities | -- | 2,060,600 |
| | ----- | ----- |
| Minority interest | 958,521 | -- |
| | ----- | ----- |
| Stockholders' equity: | | |
| Common stock, \$.01 par value, 10,000,000 shares authorized at December 31, 1999 and 1998, 5,950,879 shares issued and outstanding at December 31, 1999; 4,504,627 shares issued and outstanding | | |

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

| | | |
|----------------------------------|---------------|-------------|
| at December 31, 1998 | 59,509 | 45,046 |
| Additional paid-in capital | 25,823,817 | 17,700,833 |
| Accumulated (deficit) | (8,237,597) | (6,151,085) |
| | ----- | ----- |
| Total stockholders' equity | 17,645,729 | 11,594,794 |
| | \$ 21,538,216 | 14,867,216 |
| | ===== | ===== |

See accompanying notes to consolidated financial statements.

35

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

Years ended December 31, 1999, 1998 and 1997

| | 1999 | 1998 | 1997 |
|--|----------------|--------------|-----------|
| | ----- | ----- | ----- |
| Revenue from operations: | | | |
| Pipeline operations | \$ 1,875,716 | 2,788,944 | 4,160,000 |
| Oil and gas sales | 567,103 | 412,753 | 412,753 |
| Operating fees | 314,237 | 357,076 | 400,000 |
| | ----- | ----- | ----- |
| Revenue from operations | 2,757,056 | 3,558,773 | 4,972,753 |
| | ----- | ----- | ----- |
| Cost of operations: | | | |
| Pipeline operating expenses | 1,102,998 | 884,052 | 890,000 |
| Lease operating expenses | 1,100,549 | 846,099 | 870,000 |
| Impairment of oil and gas properties | -- | 12,011,544 | -- |
| Depletion, depreciation and amortization | 595,286 | 400,982 | 370,000 |
| General and administrative expenses | 2,061,805 | 1,466,738 | 1,350,000 |
| | ----- | ----- | ----- |
| Cost of operations | 4,860,638 | 15,609,415 | 3,490,000 |
| | ----- | ----- | ----- |
| Income (loss) from operations | (2,103,582) | (12,050,642) | 1,482,753 |
| Other income (expense): | | | |
| Interest expense | (238,322) | (215,141) | (215,141) |
| Gain on sale of assets | 2,052,920 | -- | -- |
| Interest and other income | 80,722 | 105,994 | 260,000 |
| | ----- | ----- | ----- |
| Income (loss) before income taxes | (208,262) | (12,159,789) | 1,527,612 |
| Minority interest | (882) | -- | -- |
| Income tax benefit (expense) | (1,797,033) | 3,099,810 | (540,000) |
| | ----- | ----- | ----- |
| Income (loss) before cumulative effect of a ... change in an accounting principle | (2,006,177) | (9,059,979) | 987,612 |
| Change in accounting principal (net of \$41,480 income tax) | (80,334) | -- | -- |
| | ----- | ----- | ----- |
| Net income (loss) | \$ (2,086,511) | (9,059,979) | 987,612 |
| | ===== | ===== | ===== |
| Earnings per common share-basic | | | |
| Income before accounting change | \$ (0.41) | (2.02) | |
| Cumulative effect of a change in accounting principle | (0.02) | -- | |

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

| | | | |
|---|-----------|-----------|------|
| Net income | \$ (0.43) | (2.02) | |
| Earnings per common share-diluted | | | |
| Income before accounting change | \$ (0.41) | (2.02) | |
| Cumulative effect of a change in accounting principle | (0.02) | -- | |
| Net income | \$ (0.43) | (2.02) | |
| Weighted average number of common shares outstanding and dilutive potential common shares: | | | |
| Basic | 4,837,504 | 4,492,344 | 4,46 |
| Diluted | 4,837,504 | 4,492,344 | 4,53 |

See accompanying notes to consolidated financial statements.

36

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
Years ended December 31, 1999, 1998, and 1997

| | COMMON STOCK | ADDITIONAL PAID-IN CAPITAL | ACCUMULATED (DEFICIT) | TOTAL STOCKHOLDE EQUITY |
|--|-----------------|----------------------------------|--------------------------|-------------------------------|
| | ----- | ----- | ----- | ----- |
| Balance at December 31, 1996 | \$ 44,513 | 17,630,265 | 1,925,799 | 19,600, |
| Exercise of 51,340 stock options | 513 | 159,574 | -- | 160, |
| Cancellation of 10,768 shares of stock | (108) | (110,324) | -- | (110, |
| Other | -- | (10,000) | -- | (10, |
| Net income | -- | -- | 983,095 | 983, |
| Balance at December 31, 1997 | 44,918 | 17,669,515 | 2,908,894 | 20,623, |
| Exercise of 12,780 stock options | 128 | 35,509 | -- | 35, |
| Other | -- | (4,191) | -- | (4, |
| Net loss | -- | -- | (9,059,979) | (9,059, |
| Balance at December 31, 1998 | 45,046 | 17,700,833 | (6,151,085) | 11,594, |
| Exercise of 32,004 stock options | 320 | 115,073 | -- | 115, |
| Cancellation of 14,470 shares of stock | (145) | (85,010) | -- | (85, |
| Issuance of shares to 401K plan | 200 | 59,800 | -- | 60, |
| Private placements | 10,939 | 6,159,980 | -- | 6,170, |
| Notes and accrued interest tendered for stock | 3,149 | 1,886,241 | -- | 1,889, |
| Other | -- | (13,100) | (1) | (13, |
| Net loss | -- | -- | (2,086,511) | (2,086, |
| Balance at December 31, 1999 | \$ 59,509 | 25,823,817 | (8,237,597) | 17,645, |

See accompanying notes to consolidated financial statements.

37

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended December 31, 1999, 1998, and 1997

| | 1999 | 1998 |
|---|----------------|-------------|
| | ----- | ----- |
| Operating activities: | | |
| Net income (loss) | \$ (2,086,511) | (9,059,979) |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depletion, depreciation and amortization | 595,286 | 400,982 |
| Minority interest | 882 | -- |
| Deferred income taxes | 1,765,616 | (3,113,980) |
| Change in accounting principle | 121,814 | -- |
| Gain on sale of property and equipment | (2,052,920) | -- |
| Impairment of oil and gas properties | -- | 12,011,544 |
| Changes in operating assets and liabilities: | | |
| (Increase) decrease in trade accounts receivable | (771,060) | 90,472 |
| (Increase) decrease in prepaid expenses and other assets | (298,298) | (62,750) |
| (Decrease) increase in trade accounts payable, accrued interest and other liabilities | 1,638,583 | 130,282 |
| | ----- | ----- |
| Net cash provided by (used in) operating activities | (1,086,608) | 396,571 |
| | ----- | ----- |
| Investing activities: | | |
| Oil and gas prospect generation costs | (1,268,098) | (737,868) |
| Reimbursement of oil and gas prospect generation costs | 1,292,125 | -- |
| Proceeds from sales of oil and gas prospect leases ... | -- | -- |
| Exploration and development costs | -- | (100,051) |
| Purchases of property and equipment | (10,290,563) | (354,821) |
| Net proceeds from sale of assets | 5,513,423 | -- |
| Development costs - Petroport | (299,426) | (822,086) |
| Reduction of escrowed abandonment fund | -- | 593,830 |
| Abandonment of oil and gas properties | (344,698) | -- |
| Funds escrowed for abandonment costs | (60,991) | (369,806) |
| | ----- | ----- |
| Net cash used in investing activities | (5,458,228) | (1,790,802) |
| | ----- | ----- |

See accompanying notes to consolidated financial statements.

38

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended December 31, 1999, 1998, and 1997

| | 1999 | 1998 |
|-----------------------|-------|-------|
| | ----- | ----- |
| Financing activities: | | |

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

| | | |
|---|--------------|-------------|
| Proceeds from borrowings, Bank | 200,000 | 200,000 |
| Proceeds from borrowings, Director | 1,000,000 | |
| Payments on borrowings, Bank | (330,000) | -- |
| Net proceeds from private placement | 6,170,919 | |
| Net proceeds from the exercise of stock and stock options | 77,138 | 31,446 |
| | ----- | ----- |
| Net cash provided by financing activities | 7,118,057 | 231,446 |
| | ----- | ----- |
| Increase (decrease) in cash | 573,221 | (1,162,785) |
| Cash and cash equivalents at beginning of year | 593,509 | 1,756,294 |
| | ----- | ----- |
| Cash and cash equivalents at end of year | \$ 1,166,730 | 593,509 |
| | ===== | ===== |
| Supplementary cash flow information: | | |
| Interest paid | \$ 326,819 | 214,926 |
| | ===== | ===== |
| Income taxes (received) paid | \$ 12,620 | (93,264) |
| | ===== | ===== |

NON-CASH TRANSACTIONS:

During 1999, holders of \$1,811,555 of notes payable along with accrued interest of \$77,835 converted the notes payable into 314,898 shares of Common Stock.

See accompanying notes to consolidated financial statements.

39

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS December 31, 1999, 1998 and 1997

(1) ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

ORGANIZATION

Blue Dolphin Energy Company (the Company) was incorporated in Delaware in January 1986 to engage in oil and gas exploration, production and acquisition activities and oil and gas transportation and marketing. It was formed pursuant to a reorganization effective June 9, 1986.

PRINCIPLES OF CONSOLIDATION

The consolidated financial statements of the Company include the accounts of its wholly-owned subsidiaries and majority owned subsidiary (ARO). All significant intercompany balances and transactions have been eliminated in consolidation.

ACCOUNTING ESTIMATES

Management has made a number of estimates and assumptions relating to the reporting of assets and liabilities and to the disclosure of contingent assets and liabilities including reserve information which affects the depletion calculation as well as the computation of the full cost ceiling limitation to prepare these financial statements in conformity with generally accepted accounting principles. Actual results could differ from those estimates.

CASH EQUIVALENTS

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

Cash equivalents include liquid investments with an original maturity of three months or less.

OIL AND GAS PROPERTIES

Oil and gas properties are accounted for 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 country-by-country cost center basis. Due to the difference in the expected life of the reserves of the properties, the Company uses two separate cost centers, one for its Buccaneer Field property and one for its ARO properties. Amortization of such costs and estimated future development costs is determined using the unit-of-production method. Provision for the estimated costs of offshore platform and well abandonment, net of salvage value, is computed on the units of production method and is included in depletion, depreciation and amortization. Costs directly associated with the acquisition and evaluation of unproved properties are excluded from the amortization computation until it is determined whether or not proved reserves can

(Continued)

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

be assigned to the properties or impairment has occurred. Estimated proved oil and gas reserves are based upon reports of independent petroleum engineers (ARO properties) and the Company's in-house reserve engineers (Buccaneer property). The net carrying value of oil and gas properties, less related deferred income taxes, is limited to the lower of unamortized cost or the cost center ceiling, defined as the sum of the present value (10% discount rate applied) of estimated future net revenues from proved reserves, after giving effect to income taxes, and the lower of cost or estimated fair value of unproved properties. Disposition of oil and gas properties are recorded as adjustments to capitalized costs, with no gain or loss recognized unless such adjustments would significantly alter the relationship between capitalized costs and proved reserves.

At December 31, 1998, the Company recorded an impairment charge on oil and gas properties and certain exploration activity costs of \$12,011,544, thereby adjusting the net carrying value of oil and gas properties to the cost center ceiling as described above. The impairment resulted from lower oil and gas prices and changes to the Company's development plans, whereby development of oil and gas properties have been deferred. Included in oil and gas properties at December 31, 1999 and 1998 are \$145,101 and \$198,486, respectively in expenditures directly associated with generation of additional oil and gas prospects, net of reimbursements.

The following table reflects the depletion expense incurred from oil and gas properties during the periods indicated:

| | YEAR ENDED DECEMBER 31, | | |
|---|-------------------------|------|------|
| | 1999 | 1998 | 1997 |
| Depletion expense per Mcf equivalent produced | 0.83 | 0.77 | 0.74 |

At December 31, 1999, oil and gas properties included \$950,813 of unproved

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

leasehold costs that are not being amortized. These costs will begin to be amortized when they are evaluated and proved reserves are discovered, impairment is indicated or when the lease term expires. Unproved leasehold costs consist of interests in state and federal leases located in the Gulf of Mexico with expiration dates ranging from November 2000 to November 2004. In order to retain the leases after the primary term, they must be producing or development operations must be in progress. The leases have primary terms of 5 years. Development of these leases is dependent upon the other owners of the leases to initiate a plan of development.

(Continued)

41

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table reflects the periods when costs were incurred for unproved leasehold costs:

| | YEAR ENDED DECEMBER 31, | | | |
|------------------------------|-------------------------|---------|--------|------|
| | Total | 1999 | 1998 | 1997 |
| Property acquisition costs.. | 800,469 | 800,469 | -- | -- |
| Exploration costs | 150,344 | 57,632 | 92,712 | -- |
| | 950,813 | 858,101 | 92,712 | -- |
| | 950,813 | 858,101 | 92,712 | -- |

The Company capitalizes interest on expenditures made in connection with significant exploration and production projects that are not subject to current amortization. Interest is capitalized only for the period that activities are in progress to bring these projects to their intended use. No interest has been capitalized for the periods reflected herein.

PIPELINES AND FACILITIES

Pipelines and facilities are recorded at cost. Depreciation is computed using the straight-line method over estimated useful lives of 10-25 years. Provision for the estimated cost of pipeline and facilities abandonment, net of salvage value, is computed on a straight line basis over the estimated useful life of such assets and is included in DD&A.

The Company in 1995 adopted Statement of Financial Accounting Standards (SFAS) No. 121, ACCOUNTING FOR THE IMPAIRMENT OF LONG-LIVED ASSETS AND FOR LONG-LIVED ASSETS TO BE DISPOSED OF, with no impact to the Company's consolidated financial statements. Assets are grouped and evaluated based on the ability to identify separate cash flows generated therefrom.

OTHER PROPERTY AND EQUIPMENT

Depreciation of furniture, fixtures and other equipment, including assets held under capital leases, is computed using the straight-line method over estimated useful lives of 2-5 years.

(Continued)

42

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

ABANDONMENT

A provision for the abandonment, dismantlement and site remediation of offshore production platforms and existing wells is made using the unit-of-production method applied to estimates based on current costs. A provision for pipeline and pipeline facilities abandonment costs is also provided using the straight-line method over the estimated useful lives of the pipeline and pipeline facilities. These provisions are included in accumulated depletion, depreciation, amortization and impairment, and are undiscounted. The Company previously recorded its provision for abandonment as a non-current liability. Aggregate abandonment liability is estimated to be approximately \$3,960,000 at December 31, 1999 and 1998.

NEW AVOCA

The Company records its investment in New Avoca using the equity method of accounting. Under the equity method, investments are recorded at cost plus the Company's equity in undistributed earnings and losses after acquisition.

STOCK-BASED COMPENSATION

The Company applies SFAS No. 123, ACCOUNTING FOR STOCK-BASED COMPENSATION, which allows a company to adopt a fair value based method of accounting for a stock-based employee compensation plan or to continue to use the intrinsic value based method of accounting prescribed by Accounting Principles Board Opinion No. 25, ACCOUNTING FOR STOCK ISSUED TO EMPLOYEES. The Company has chosen to continue to account for stock-based compensation under the intrinsic value method and provides the pro forma effects of the fair value method as required.

RECOGNITION OF CRUDE OIL AND NATURAL 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 the Company's net revenue interest in production. Similarly, when deliveries are below the Company's net revenue interest in production, sales are recorded to reflect the full net revenue interest. The Company's imbalance liability at December 31, 1999 and 1998 was not material.

(Continued)

43

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

RECOGNITION OF PIPELINE TRANSPORTATION REVENUE

Revenue from the transportation of gas, condensate and crude oil is recognized on the accrual basis as products are transported.

OPERATION OF OIL AND GAS PROPERTIES

The Company operates, for a monthly fee, oil and gas properties in which it does not own an interest. Revenues and costs from these activities are included in operating fees and lease operating expenses, respectively. Operating fees received related to properties in which the Company owns an interest are netted against the appropriate operating costs in the Statement of Operations. Fees received in excess of costs incurred are reflected as a reduction of the full cost pool.

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

INCOME TAXES

The Company provides for income taxes using the asset and liability method pursuant to SFAS No. 109, ACCOUNTING FOR INCOME TAXES (Statement 109). Under the asset and liability method of Statement 109, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

EARNINGS PER SHARE

The Company follows SFAS No. 128 (Statement 128), EARNINGS PER SHARE, for computing and presenting earnings per share and requires, among other things, dual presentation of basic and diluted earnings per share on the face of the statement of operations.

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

(Continued)

44

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

| | NET INCOME | WEIGHTED AVERAGE COMMON SHARES OUTSTANDING AND DILUTIVE POTENTIAL COMMON SHARES | PER SHARE AMOUNT |
|----------------------------------|----------------|---|------------------------|
| | ----- | ----- | ----- |
| Year ended December 31, 1999 | | | |
| Basic (loss) per share | \$ (2,086,511) | 4,837,504 | \$ (0.43) |
| | ----- | ----- | ----- |
| Diluted (loss) per share | \$ (2,086,511) | 4,837,504 | \$ (0.43) |
| | ===== | ===== | ===== |
| Year ended December 31, 1998 | | | |
| Basic (loss) per share | \$ (9,059,979) | 4,492,344 | \$ (2.02) |
| | ----- | ----- | ----- |
| Diluted (loss) per share | \$ (9,059,979) | 4,492,344 | \$ (2.02) |
| | ===== | ===== | ===== |
| Year ended December 31, 1997 | | | |
| Basic earnings per share | \$ 983,095 | 4,462,072 | \$ 0.22 |
| Effect of dilutive stock | | | |
| Options | -- | 69,136 | -- |
| | ----- | ----- | ----- |
| Diluted earnings per share | \$ 983,095 | 4,531,208 | \$ 0.22 |
| | ===== | ===== | ===== |

(Continued)

45

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The weighted average number of Common Shares and potential Common Shares outstanding for the year ended December 31, 1997 reflects the one-for-fifteen reverse stock split effected on December 8, 1997.

The employee stock options at December 31, 1999 and 1998, were not included in the computation of diluted earnings per share because the effect of their assumed exercise and conversion would have an antidilutive effect on the computation of diluted loss per share.

The following unaudited pro forma information for the years ended December 31, 1999 and 1998, presents a summary of consolidated results of operations as if the acquisition of the 75% ownership interest in ARO made in 1999 had occurred on January 1, 1998 with pro forma adjustments to give effect to depreciation and certain other adjustments together with related income tax effects:

| | YEAR ENDED DECEMBER 31, | |
|--|----------------------------|---------------|
| | 1999 | 1998 |
| Revenues | \$ 5,726,056 | \$ 8,995,773 |
| Net Earnings | \$(2,257,225) | \$(7,905,549) |
| Basic and diluted earnings per share . | \$ (0.47) | \$ (1.76) |

The above pro forma information is not necessarily indicative of the results of operations as they would have been had the acquisition been effected on January 1, 1998.

ENVIRONMENTAL

The Company is subject to extensive Federal, state and local environmental laws and regulations. These laws, which are constantly changing, regulate the discharge of materials into the environment and may require the Company to remove or mitigate the environmental effects of the disposal or release of petroleum or chemical substances at various sites. Environmental expenditures are expensed or capitalized depending on their future economic benefit. Expenditures that relate to an existing

(Continued)

46

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

condition caused by past operations and that have no future economic benefits are expensed. Liabilities for expenditures of a noncapital nature are recorded when environmental assessment and/or remediation is probable, and the costs can be reasonably estimated. Such liabilities are generally recorded at their undiscounted amounts unless the amount and timing of payments is fixed or reliably determinable.

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

COSTS OF START-UP ACTIVITIES

In April 1998, the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants issued Statement of Position 98-5, Reporting on the Costs of Start-Up Activities ("SOP 98-5"). SOP 98-5 requires that costs of start-up activities be charged to expense as incurred and broadly defines such costs. The Company deferred certain costs incurred in connection with a new business segment, and SOP 98-5 requires that such deferred costs be charged to results of operations upon its adoption. The Company adopted the requirements of SOP 98-5 on January 1, 1999. The cumulative effect of the change in accounting principle for the adoption of SOP 98-5 resulted in a charge to results of operations in the financial statements for the year ended December 31, 1999 of \$80,334, net of \$41,480 of income taxes.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS No. 133), was issued by the Financial Accounting Standards Board in June 1998. SFAS No. 133 standardizes the accounting for derivative instruments, including certain derivative instruments embedded in other contracts. In July 1999, SFAS NO. 137, "Deferral of the Effective Date of SFAS NO.133," was issued and delays the effective date for one year, to fiscal years beginning after June 15, 2000. The Company believes that adoption of this financial accounting standard will not have a material effect on its financial condition or results of operations.

(2) FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying values of cash and cash equivalents, receivables and accounts payable approximate fair value due to the short-term maturities of these instruments. The carrying value of the notes payable approximates fair value at December 31, 1999 and 1998.

(Continued)

47

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(3) INCOME TAXES

Income tax expense for 1999, 1998 and 1997 consists of:

| | 1999 | 1998 | 1997 |
|------------------------|--------------|-------------|---------|
| | ----- | ----- | ----- |
| Current: | | | |
| Federal | \$ -- | -- | 25,466 |
| State | -- | 14,170 | 50,800 |
| Deferred - Federal ... | 1,797,033 | (3,113,980) | 469,965 |
| | ----- | ----- | ----- |
| | \$ 1,797,033 | (3,099,810) | 546,231 |
| | ===== | ===== | ===== |

The income tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 1999 and 1998 are presented below.

| | 1999 | 1998 |
|--|-------|-------|
| | ----- | ----- |

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

| | | |
|--|--------------|--------------|
| Deferred tax assets: | | |
| Accrued abandonment costs | \$ 136,354 | \$ 84,541 |
| Net operating loss carryforwards | 9,800,517 | 2,685,789 |
| Alternative minimum tax credit | 244,444 | 244,444 |
| Basis differences in property and equipment | 1,425,746 | 29,295 |
| | ----- | ----- |
| Total gross deferred tax assets ... | 11,607,061 | 3,044,069 |
| Deferred tax liabilities: | | |
| State tax | (34,009) | (34,009) |
| | ----- | ----- |
| Total gross deferred tax liability | (34,009) | (34,009) |
| | ----- | ----- |
| Net deferred tax asset (liability) | 11,573,052 | 3,010,060 |
| | ----- | ----- |
| Less valuation allowance | (11,328,608) | (1,000,000) |
| | ----- | ----- |
| Deferred tax asset (liability) ... | \$ 244,444 | \$ 2,010,060 |
| | ===== | ===== |

In 1999, the Company acquired ARO, which had deferred tax assets of approximately \$8.5 million made up of basis differences in oil and gas properties and net operating losses. A full valuation allowance has been recorded to reduce the corresponding deferred assets, since it is more likely than not that they will not be

(Continued)

48

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

realized, due to the limitation of the use of the net operating loss carryforwards resulting from the ownership change in December 1999.

In assessing the realizability of deferred tax assets, the Company applies SFAS No. 109 to determine whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. As a result, the Company recorded a valuation allowance at December 31, 1999 to reduce the deferred tax asset to \$244,444.

The Company's effective tax rate applicable to continuing operations in 1999, 1998 and 1997 differs from the expected tax rate of 34% due to the following:

| | 1999 | 1998 | 1997 |
|---|-------|-------|-------|
| | ----- | ----- | ----- |
| Expected tax rate | (34%) | (34%) | 34% |
| State taxes, net of federal benefit | -- | -- | 1% |
| Expenses not deductible for tax purposes . | 2% | -- | 1% |
| Increase in valuation allowance recognized in earnings | 893% | 8% | -- |
| | ----- | ----- | ----- |
| Other | 2% | -- | -- |
| | ----- | ----- | ----- |
| | 863% | (26%) | 36% |
| | ===== | ===== | ===== |

For federal tax purposes, the company had a net operating loss carryforward ("NOL") of approximately \$28.8 million and \$7.9 million for the years ended December 31, 1999 and 1998. These NOLs must be utilized prior to their expiration, which is between 2000 and 2018. Of the \$28.8

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

million of NOLs for the year ended December 31, 1999, \$21.0 million relates to ARO.

The Company has an alternative minimum tax credit carry forward of \$244,444 that does not expire and may be applied to reduce regular tax to an amount not less than the alternative minimum tax payable in any one year.

(4) LONG-TERM DEBT

The Company maintains a reducing revolving credit facility (Loan Agreement) with Bank One, Texas, N.A. (Bank One), in an amount of \$10,000,000. At December 31, 1999, the borrowing base under the Loan Agreement was \$80,000 and reduced to \$0

(Continued)

49

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

in January 2000. The Company paid off the \$80,000 balance of the credit facility in January 2000. The borrowing base is redetermined semi-annually. On the first day of each month interest is due and payable on the outstanding loan balance at the rate of 1.25% above Bank One's prime rate of interest. Borrowings under the Loan Agreement are secured by first liens on the Buccaneer Field, the Blue Dolphin Pipeline, the Buccaneer Pipeline, the Freeport, Texas acreage, the Shore Facilities and the Black Marlin Pipeline. The maturity date under the Loan Agreement is December 31, 2000.

The Loan Agreement includes certain restrictive covenants, including a restriction of the payment of dividends on capital stock and the maintenance of certain financial coverage ratios. The Company was in compliance with these covenants at December 31, 1999.

In December 1996, the Company issued \$2,050,600 in promissory notes to the holders of the Preferred Stock as full payment of the cumulative preferred stock dividends. The promissory notes are unsecured and bear interest at the rate of 10.25% per annum. Interest only is payable semi-annually with the principal due on December 31, 2000. The Company may prepay all or a portion of the principal at any time prior to maturity with no penalty. On December 1, 1999, the holders of promissory notes totaling \$1,811,555 tendered their promissory notes, along with accrued interest of \$77,835 for common stock pursuant to the Company's private placement of shares. Additionally, the Company retired \$20,634 principal amount of promissory notes in January 2000.

Long-term debt at December 31, 1999 and 1998 is as follows:

(Continued)

50

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31,

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

| | 1999 | 1998 |
|--|-------------|-------------|
| | ----- | ----- |
| Note payable - related party, interest at 10% per annum, principal due June 1, 2000, convertible into common stock at \$6.60 per share | \$1,000,000 | -- |
| \$10,000,000 bank credit facility, \$80,000 borrowing base, interest payable monthly at prime rate (8.5% at December 31, 1999) plus 1.25%. Borrowing availability and reducing base amount are redetermined semiannually | 80,000 | \$ 210,000 |
| Notes payable, interest at 10.25% per annum payable semi-annually, principal due December 31, 2000 | 239,045 | 2,050,600 |
| | ----- | ----- |
| | 1,319,045 | 2,260,600 |
| Less current maturities, including note payable-related party | 1,319,045 | 200,000 |
| | ----- | ----- |
| | \$ -- | \$2,060,600 |
| | ===== | ===== |

(5) STOCKHOLDERS' EQUITY

In June 1999, the Company received \$1,960,000 through a private placement of 392,000 shares of its' common stock, \$.01 par value per share, at \$5.00 per share. The proceeds were used to replenish working capital previously used for planned investments in longer term, high potential projects and for general working capital.

In order to provide funding for the acquisition of ARO in December 1999, the Company arranged a private placement and conversion of principal and accrued interest on promissory notes into common stock, \$.01 par value per share, of 701,820 shares and 314,898 shares, respectively and a \$1,000,000 convertible promissory note, see notes 4 and 7. The shares were issued at a price of \$6.00 per share. Consideration for the common stock sold consisted of approximately \$4,210,919 cash and the surrender of approximately \$1,811,555 of the Company's promissory

(Continued)

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

notes due December 31, 2000, along with accrued interest of \$77,835 through December 1, 1999.

(6) STOCK OPTIONS

The Company adopted a new stock option plan in 1996 (the Plan). The stock subject to the options and other provisions of the Plan are shares of the Company's Common Stock, \$.01 par value (the Stock). The total amount of the Stock with respect to which options may be granted shall not exceed in the aggregate 10% of the number of issued and outstanding shares of Common Stock of the Company. The stock options become exercisable from time to

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

time in part or as a whole, as the Compensation Committee (the Committee), appointed by the Board of Directors, or the Board of Directors in their discretion may provide. However, the Committee shall not grant options which may become exercisable in any one calendar year to purchase more than one-third of the maximum amount granted. All options expire five years after the date of grant. The price of options granted may not be less than eighty-five percent of the fair market value of the Stock on the date the option is granted. Optionees must continue their association with the Company for six months after exercising the options, or the underlying stock reverts to the Company. All shares issued for options exercised in the current year are restricted at December 31, 1999. The Company's previous stock option plan, with terms and conditions essentially the same as those of the Plan, expired in 1995.

At December 31, 1999 the Company has reserved a total of 519,229 shares of Common Stock for issuance under the above mentioned stock option plans, of which 85,324 shares relate to options granted prior to 1996, under the previous stock option plan. The outstanding stock options granted to key employees, officers and directors, for the purchase of shares of the Company's Common Stock, are as follows:

(Continued)

52

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

| | SHARES | EXERCISE PRICE PER SHARE | |
|------------------------------|----------|-----------------------------|-------|
| | | FROM | TO |
| Balance, December 31, 1997 . | 196,016 | 2.391 | 4.383 |
| Expired | (32,005) | 4.383 | 2.789 |
| Exercised | (12,780) | 2.789 | 2.789 |
| Balance, December 31, 1998 . | 151,231 | 2.789 | 4.383 |
| Granted | 72,100 | 3.125 | 5.000 |
| Expired | (14,223) | 4.383 | 2.789 |
| Exercised | (32,004) | 2.789 | 4.383 |
| Balance, December 31, 1999 . | 177,104 | 2.789 | 5.000 |

The weighted average exercise price per share was \$3.606 and \$2.789 in 1999 and 1998, respectively.

As of December 31, 1999, options for 81,478 shares of stock were immediately exercisable. There were 72,100 options granted in 1999. Pursuant to the requirements of FASB No. 123, the weighted average fair market value of options granted during 1999 and 1997 are \$1.57 and \$2.66, respectively. The weighted average closing bid prices for the Company's stock at the date the options were granted during 1999 and 1997 are \$3.34 and \$4.50, respectively. The fair market value pursuant to FASB No. 123 of each option granted is estimated on the date of grant using the Black-Scholes options-pricing model. The model assumed expected volatility of 61% and 80% and risk-free interest rates of 3.75% for grants in 1999 and 1997, and an expected life of 3 years. As the Company has not declared dividends since it became a public entity, no dividend yield was used.

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

Actual value realized, if any, is dependent on the future performance of the Company's Common Stock and overall stock market conditions. There is no assurance the value realized by an optionee will be at or near the value estimated by the Black-Scholes model.

As discussed in Note 1, no compensation expense has been recorded in 1999, 1998, and 1997 for stock options granted. Had compensation cost for the Company's stock option plans been determined based on the fair market value at the grant dates for awards made after December 31, 1996 under those plans, the Company's net income

(Continued)

53

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(loss) and earnings (loss) per share would have been reduced to the pro forma amounts indicated below:

| | | YEAR ENDED DECEMBER 31, | | |
|--------------------------------------|-------------|-------------------------|---------------|------------|
| | | 1999 | 1998 | 1997 |
| Net income (loss) | As reported | \$(2,086,511) | \$(9,059,979) | \$ 983,095 |
| | Pro forma | (2,190,033) | (9,172,801) | 801,555 |
| Basic earnings (loss) per share | As reported | (0.43) | (2.02) | 0.22 |
| | Pro forma | (0.45) | (2.04) | 0.18 |
| Diluted earnings (loss) per share | As reported | (0.43) | (2.02) | 0.22 |
| | Pro forma | (0.45) | (2.04) | 0.18 |

Outstanding options at December 31, 1999 expire between August 18, 2000 and January 14, 2004.

Under the provisions of SFAS No. 123, the pro forma disclosures above include only the effects of stock options granted by the Company subsequent to December 31, 1994. During this initial phase-in period, the pro forma disclosures as required by SFAS No. 123 are not representative of the effects on reported net income for future years as options vest over several years and additional awards are generally made each year and there is a risk of forfeiture.

(7) RELATED PARTY TRANSACTIONS

Related party transactions which are not disclosed elsewhere in these consolidated financial statements are discussed in the following paragraph.

In June 1999, the Company received \$1,960,000 through a private placement of 392,000 shares of its' common stock, \$.01 par value per share, at \$5.00 per share. A director of the Company participated in the private placement, purchasing 100,000 shares.

In order to provide funding for the acquisition of ARO in December 1999, the Company arranged a private placement and conversion of principal and accrued interest on promissory notes into common stock, \$.01 par value per share, of 701,820 shares and 314,898 shares, respectively. The shares were issued at a price of \$6.00 per share. Consideration for the common stock sold consisted of approximately \$4,210,919 cash

(Continued)

54

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

and the surrender of approximately \$1,811,555 of the Company's promissory notes due December 31, 2000, along with accrued interest of \$77,835 through December 1, 1999. Three directors of the Company participated in this private placement; one director paid \$100,002 for 16,667 shares and tendered a note in the amount of \$95,761 plus accrued interest of \$4,114 and cash \$325 for 16,700 shares, another director tendered a note in the amount of \$179,921 plus accrued interest of \$7,730 and cash \$149 for 31,300 shares and a third director tendered a note in the amount of \$26,769 plus accrued interest of \$1,150 and cash \$281 for 4,700 shares.

On December 1, 1999, the Company issued a \$1,000,000 promissory note to a director of the Company. The note is due June 1, 2000 bears interest at 10% per annum, and is convertible into common stock at \$6.60 per share. The due date of the note was subsequently extended to March 31, 2001 and is convertible into common stock at \$6.00 per share.

In 1992, the Company entered into a contract with a company, in which a director of the Company is a principal, for business development consulting services. The Company paid \$71,250 and \$90,000 under the contract in 1998 and 1997, respectively. The contract was terminated October 15, 1998.

(8) LEASES

The Company has various noncancelable operating leases which continue through 2006.

The following is a schedule of future minimum lease payments required under noncancelable operating leases at December 31, 1999:

| YEARS ENDING DECEMBER 31, ----- | |
|---------------------------------------|--------------|
| 2000 | \$ 190,211 |
| 2001 | 198,548 |
| 2002 | 186,498 |
| 2003 | 185,521 |
| 2004 | 195,617 |
| Thereafter | 391,234 |
| | ----- |
| | \$ 1,347,629 |

(Continued)

55

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Rental expense under operating leases for the years indicated are as follows:

| YEARS ENDING DECEMBER 31, ----- | |
|---------------------------------------|------------|
| 1999 | \$ 136,310 |
| 1998 | 119,490 |
| 1997 | 222,838 |

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

(9) COMMITMENTS AND CONTINGENCIES

In 1993, the United States Department of the Interior, Minerals Management Service (MMS) required the Company's wholly-owned subsidiary, Blue Dolphin Exploration Company (BDEX), to provide additional security to ensure it could meet the future abandonment and site clearance obligations associated with the Buccaneer Field. In February 1994, BDEX and the MMS agreed on the form of such security and the amount of the future obligations.

As additional security for the future Buccaneer Field abandonment and site clearance obligations, in February 1994, BDEX provided the MMS with a \$700,000 supplemental surety bond. In October 1996, BDEX provided the MMS with an additional \$600,000 supplemental surety bond. The Company's annual abandonment escrow fund payment of \$250,000 that was due in June 1999 was not made as a result of the removal of the inactive satellite platform in 1999 at a cost of approximately \$345,000.

Additionally, a sinking fund was established in 1994 wherein \$250,000 annually will be set aside until a total of approximately \$2,400,000 has been accumulated to meet end of lease abandonment and site clearance obligations. The Company estimates the remaining useful life of its major Buccaneer Field facilities to be in excess of ten years.

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.

(Continued)

56

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(10) 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, which includes mid steam projects. 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 years ended December 31, 1999, 1998, and 1997 is as follow:

| | REVENUES | INTERSEGMENT REVENUES | OPERATING INCOME (LOSS) (1) |
|--|------------|--------------------------|-----------------------------------|
| Year ended December 31, 1999: | | | |
| Oil and gas exploration, production and operating fees | \$ 887,340 | 6,000 | (892,032) |
| Pipeline operations | 1,889,837 | 14,121 | (551,339) |

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

| | | | |
|--|------------|--------|--------------|
| Other | (20,121) | | (660,211) |
| | ----- | | ----- |
| | 2,757,056 | -- | (2,103,582) |
| Other income | | | 1,895,320 |
| | | | ----- |
| Loss before income taxes | | | (208,262) |
| Year ended December 31, 1998: | | | |
| Oil and gas exploration, production and operating fees | \$ 777,829 | 8,000 | (12,448,875) |
| Pipeline operations | 2,818,921 | 29,976 | 739,610 |
| Other | (37,976) | | (341,377) |
| | ----- | | ----- |
| Consolidated | 3,558,774 | -- | (12,050,642) |
| Other expense | | | (109,147) |
| | | | ----- |
| Loss before income taxes | | | (12,159,789) |
| Year ended December 31, 1997: | | | |
| Oil and gas exploration, production and operating fees | \$ 828,013 | 8,000 | (384,459) |
| Pipeline operations | 4,192,343 | 29,750 | 2,308,995 |
| Other | (37,750) | | (458,681) |
| | ----- | | ----- |
| Consolidated | 4,982,606 | -- | 1,485,855 |
| Other income | | | 43,471 |
| | | | ----- |
| Income before income taxes | | | 1,529,326 |

(Continued)

57

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

- (1) Consolidated income from operations includes \$602,845, \$564,584 and \$373,040 in unallocated general and administrative expenses, and unallocated depletion, depreciation and amortization of \$37,245, \$28,512 and \$27,391 for the years ended December 31, 1999, 1998 and 1997, respectively.
- (2) Pipeline depletion, depreciation and amortization includes a provision for pipeline abandonment of \$20,840, \$26,340 and \$26,340, for the years ended December 31, 1999, 1998 and 1997 respectfully. Oil and gas depletion, depreciation and amortization includes a provision for abandonment costs of platforms and wells of \$17,656, \$30,378 and \$28,466 for the years ended December 31, 1999, 1998 and 1997, respectively.

See the supplemental disclosures for oil and gas producing activities for discussion of capitalized costs incurred for oil and gas production operations. Capital expenditures of \$3,028,216 were incurred for pipeline operations for the year ended December 31, 1999. Capitalized expenditures of \$299,426 were incurred for mid stream projects for the year ended December 31, 1999.

The Company's primary market area is the Texas Gulf Coast region of the United States. The Company has a concentration of credit risk with

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

customers in the energy and petro chemical industries. The Company's customers may be similarly affected by changes in economic, regulatory or other factors. Trade receivables are generally not collateralized; however, the Company's customers' historical and future credit positions are thoroughly analyzed prior to extending credit. Revenues from major customers exceeding 10% of segment revenues were as follows for the periods indicated:

(Continued)

58

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

| | OIL AND GAS SALES AND OPERATING FEES | PIPELINE OPERATIONS | TOTAL |
|--------------------------------|--|------------------------|-----------|
| | ----- | ----- | ----- |
| Year ended December 31, 1999: | | | |
| Apache Corporation | \$ 295,525 | 723,437 | 1,018,962 |
| The Dow Chemical Company | 227,778 | 22,512 | 250,290 |
| Year ended December 31, 1998: | | | |
| Apache Corporation | \$ 333,787 | 1,504,375 | 1,838,162 |
| The Dow Chemical Company | 391,913 | 46,119 | 438,032 |
| Burlington Resources | -- | 429,186 | 429,186 |
| Year ended December 31, 1997: | | | |
| Apache Corporation | \$ 359,376 | 1,466,621 | 1,825,997 |
| The Coastal Corporation | 39,905 | 1,111,885 | 1,151,790 |
| Burlington Resources | -- | 642,492 | 642,492 |
| The Dow Chemical Company | 393,443 | 114,381 | 507,824 |

(11) SUPPLEMENTAL OIL AND GAS INFORMATION - UNAUDITED

The following supplemental information regarding the oil and gas activities of the Company is presented pursuant to the disclosure requirements promulgated by the Securities and Exchange Commission (SEC) and SFAS No. 69 DISCLOSURES ABOUT OIL AND GAS PRODUCING Activities (Statement 69).

Per discussion with the Securities and Exchange Commission, proved reserves previously reported at December 31, 1999 have been revised to eliminate proved undeveloped reserves attributable to the Buccaneer Field, before income taxes. This revision has eliminated 76,074 barrels of oil and 13,123,893 Mcf of natural gas thereby decreasing the standardized measure of discounted future net cash inflow by \$1,234,601.

At December 31, 1999, the Buccaneer Field accounted for 59% of the Company's discounted future net cash flows from proved reserves.

(Continued)

59

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The timing and amount of estimated future development costs may

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

significantly increase or decrease the Company's total proved and proved developed reserve volumes, the Standardized Measure of Discounted Future Net Cash Flows, and the components and changes therein.

ESTIMATED QUANTITIES OF PROVED OIL AND GAS RESERVES

Set forth below is a summary of the changes in the estimated quantities of the Company's crude oil and condensate, and natural gas reserves for the periods indicated, as estimated by the Company (Buccaneer Field), Netherland Sewell & Associates Inc. (ARO) and Ryder Scott Company (ARO). All of the Company's reserves are located within the United States. Proved reserves cannot be measured exactly because the estimation of reserves involves numerous judgmental determinations. Accordingly, reserve estimates must be continually revised as a result of new information obtained from drilling and production history, new geological and geophysical data and changes in economic conditions.

Proved reserves are estimated quantities of natural gas, crude oil, and condensate which geological and engineering data demonstrate, with reasonable certainty, to be recoverable in future years from known reservoirs under existing economic and operating conditions. Proved developed reserves are proved reserves that can be expected to be recovered through existing wells with existing equipment and operating method.

(Continued)

60

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

| QUANTITY OF OIL AND GAS RESERVES | OIL (BBLs) | GAS (MCF) |
|---|---------------|--------------|
| | ----- | ----- |
| Total proved reserves at December 31, 1995 | 202,166 | 33,097,136 |
| Revisions to previous estimates | (6,477) | (201,823) |
| Production | (1,887) | (180,269) |
| | ----- | ----- |
| Total proved reserves at December 31, 1996 | 193,802 | 32,715,044 |
| Revisions to previous estimates | (8,500) | (1,125,504) |
| Production | (1,156) | (176,986) |
| | ----- | ----- |
| Total proved reserves at December 31, 1997 | 184,146 | 31,412,554 |
| | ===== | ===== |
| Revisions to previous estimates | 6,743 | (40,387) |
| Production | (1,628) | (177,260) |
| | ----- | ----- |
| Total proved reserves at December 31, 1998 | 189,261 | 31,194,907 |
| | ===== | ===== |
| Acquisitions | 150,012 | 4,419,130 |
| Revisions to previous estimates | (76,711) | (13,226,766) |
| Production | (6,338) | (169,329) |
| | ----- | ----- |
| Total proved reserves at December 31, 1999 (Restated) | 256,224 | 22,217,942 |
| | ===== | ===== |
| Proved developed reserves: | | |
| December 31, 1999 | 205,525 | 20,400,120 |
| December 31, 1998 | 113,183 | 18,070,961 |

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

December 31, 1997 108,068 18,288,608

(Continued)

61

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

CAPITALIZED COSTS OF OIL AND GAS PRODUCING ACTIVITIES

The following table sets forth the aggregate amounts of capitalized costs relating to the Company's oil and gas producing activities and the aggregate amount of related accumulated depletion, depreciation and amortization as of the dates indicated:

| | DECEMBER 31, | |
|---|---------------|--------------|
| | 1999 | 1998 |
| Unproved properties and prospect generation costs not being amortized | \$ 950,813 | 227,286 |
| Proved properties being amortized | 25,524,144 | 20,983,520 |
| Less accumulated depletion, depreciation, amortization and impairment | (16,129,385) | (15,957,436) |
| Net capitalized costs | \$ 10,345,572 | 5,253,370 |

At December 31, 1998 the Company recorded an impairment charge on its oil and gas properties and certain exploration activity costs of \$12,011,544, resulting from lower oil and gas prices and changes to its development plans, whereby development of oil and gas properties have been deferred.

The Company previously reported its provision for abandonment as a liability separately on the balance sheet. The Company has reclassified the accrued abandonment liability to be reflected as a component of accumulated depletion, depreciation and amortization.

COSTS INCURRED IN OIL AND GAS PRODUCING ACTIVITIES

The following table reflects the costs incurred in oil and gas property acquisition, exploration and development activities during the periods indicated:

(Continued)

62

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

| DECEMBER 31, | | |
|--------------|------|------|
| 1999 | 1998 | 1997 |

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

| | | | |
|----------------------------|-------------|---------|---------|
| Property acquisition costs | \$4,538,939 | -- | 471,861 |
| Exploration costs | 57,632 | 277,501 | -- |
| Development costs | -- | -- | 23,685 |
| | ----- | ----- | ----- |
| | \$4,596,571 | 277,501 | 495,546 |
| | ===== | ===== | ===== |

STANDARDIZED MEASURE OF DISCOUNTED
FUTURE NET CASH FLOWS

The following table reflects the Standardized Measure of Discounted Future Net Cash Flows relating to the Company's interest in proved oil and gas reserves as of:

| | DECEMBER 31, | |
|--|---------------|--------------|
| | 1999 | 1998 |
| | ----- | ----- |
| | (Restated) | |
| Future cash inflows | \$ 54,304,207 | 60,296,555 |
| Future development costs | (5,208,880) | (9,782,601) |
| Future production costs | (15,655,715) | (25,093,865) |
| | ----- | ----- |
| Future net cash inflows | | |
| before income taxes | 33,439,612 | 25,420,089 |
| Future income taxes | (195,748) | (213,271) |
| | ----- | ----- |
| Future net cash flows | 33,243,864 | 25,206,818 |
| 10% discount factor | (18,340,109) | (19,235,787) |
| | ----- | ----- |
| Standardized measure of discounted future net cash inflow | \$ 14,903,755 | 5,971,031 |
| | ===== | ===== |

Future net cash flows at each year end, as reported in the above schedule, were determined by summing the estimated annual net cash flows computed by: (1) multiplying estimated quantities of proved reserves to be produced during each year by current prices (at December 31, 1999, such prices were \$24.66 per barrel of oil and \$2.16 per Mcf of gas) and (2) deducting estimated expenditures to be incurred during each year to develop and produce the proved reserves (based on current costs).

(Continued)

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The price the Company uses to value its oil is higher than year-end posted market prices. This is due to the premium the Company receives over posted market prices, primarily from the Buccaneer Field, due to location and quality differentials. The Buccaneer Field produces high gravity oil.

Income taxes were computed by applying year-end statutory rates to pretax net cash flows, reduced by the tax basis of the properties and available net operating loss carryforwards. The annual future net cash flows were discounted, using a prescribed 10% rate, and summed to determine the standardized measure of discounted future net cash flow.

The Company cautions readers that the standardized measure information which places a value on proved reserves is not indicative of either fair

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

market value or present value of future cash flows. Other logical assumptions could have been used for this computation which would likely have resulted in significantly different amounts. Such information is disclosed solely in accordance with Statement 69 and the requirements promulgated by the SEC to provide readers with a common base for use in preparing their own estimates of future cash flows and for comparing reserves among companies. Management of the Company does not rely on these computations when making investment and operating decision. Principal changes in the STANDARDIZED MEASURE OF DISCOUNTED FUTURE NET CASH FLOWS attributable to the Company's proved oil and gas reserves for the periods indicated are as follows

(Continued)

64

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

| | DECEMBER 31, | | |
|---|--------------|--------------|-------------|
| | 1999 | 1998 | 1997 |
| | (Restated) | | |
| Sales and transfers, net of production costs* | \$ 555,450 | 433,346 | 489,564 |
| Acquisitions of reserves | 4,335,908 | -- | -- |
| Net change in estimated future development costs | 2,523,249 | 18,918 | 165,389 |
| Net change in income taxes | 17,523 | 5,322,055 | 267,388 |
| Revisions in previous quantity estimates | (9,433,590) | 34 | (996,557) |
| Net changes in sales and transfer prices, net of production costs | 9,503,801 | (10,944,737) | (548,223) |
| Accretion of discount | 618,430 | 2,277,393 | 2,432,226 |
| Change in production rates (timing) and other | 811,953 | (7,835,514) | (3,090,710) |
| Net change | \$ 8,932,724 | (10,728,505) | (1,280,923) |

*23% of the Company's estimated proved oil reserves and 7% of its estimated proved gas reserves were being produced at December 31, 1999.

(12) ACQUISITIONS

BLACK MARLIN PIPELINE SYSTEM. On March 1, 1999 the Company acquired 10% of the stock of Black Marlin Pipeline Company from Enron Pipeline Company ("Enron"), for \$5,404,270 cash. In addition, Enron received an option to acquire a minimum of 25% and a maximum of 33-1/3% of the Black Marlin Pipeline System, if Black Marlin Pipeline should become no longer subject to rate and tariff regulation by the Federal Energy Regulatory Commission. This option will expire on the earlier of the third anniversary of notice that the Black Marlin Pipeline is no longer subject to rate and tariff regulation or March 1, 2004. Black Marlin Pipeline Company is the owner of the Black Marlin Pipeline System. The Black Marlin Pipeline System includes the Black Marlin Pipeline, onshore facilities for condensate and gas separation and dehydration, 3,000 Bbls of above ground tankage for storage of condensate, a truck loading facility for oil and condensate, and 5 acres of land in Galveston County, Texas where the Black Marlin Pipeline comes ashore and on which are located the pipeline system's

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

shore facilities. The Black Marlin Pipeline consists of two segments. The offshore segment transports natural gas and condensate and is comprised of approximately 67 miles of 16-inch pipeline from a High Island Block 136 platform including an

(Continued)

65

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

extension from a platform in High Island Block A-6, to an interconnection in High Island Block 137, across Galveston Bay to the onshore facilities at Texas City, Texas. The offshore segment also includes approximately 7 miles of 8-inch pipeline from a platform in High Island Block 199 to an interconnection with the main line in High Island Block 171. The onshore segment consists of approximately 2 miles of 16-inch pipeline from the shore facilities to an end user and pipeline system tie-ins. This acquisition was funded by selling a one-sixth (1/6) undivided interest in the Company's Blue Dolphin Pipeline System, the Black Marlin Pipeline System and the Omega Pipeline to WBI Southern, Inc. ("WBI") for \$3,712,000 and selling a one-third (1/3) undivided interest in the Black Marlin Pipeline System to MCNIC Pipeline and Processing Company ("MCNIC") for \$1,801,423. These sales were completed effective March 1, 1999. In addition, conditional consideration may be received from WBI up to a maximum of \$500,000 during the four-year period ending February 28, 2003, if pre-tax cash flow exceeds certain targets. For the annual period ended February 29, 2000, pre-tax cash flow was below the target level, thus no conditional consideration was received by the Company. MCNIC owns a one-third (1/3) undivided interest in the Blue Dolphin Pipeline System and the Omega Pipeline. WBI and MCNIC are both independent third parties to the Company.

AMERICAN RESOURCES OFFSHORE, INC. On December 2, 1999, BDEX acquired a 75% ownership interest in ARO. The purchase price for the ARO shares was approximately \$4.5 million. Concurrently with the sale to BDEX, ARO sold an 80% interest in its Gulf of Mexico assets to Fidelity Oil Holdings, Inc. a subsidiary of MDU Resources Group, Inc. ("MDU") and an independent third party to the Company. The proceeds received by ARO were used to retire certain indebtedness.

ARO's assets consist of an average 6% non-operated working interest in eight producing properties and one proved undeveloped property along with leasehold interests in 34 additional offshore tracts, all located in the Gulf of Mexico offshore Louisiana and Texas. At closing, all significant liabilities of ARO were settled and substantially all stock options and warrants were eliminated.

66

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURES

None.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The information required by Item 10 is incorporated by reference to the Company's definitive proxy statement relating to its 2000 annual meeting of stockholders filed with the SEC on April 20, 2000.

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

ITEM 11. EXECUTIVE COMPENSATION

The information required by Item 11 is incorporated by reference to the Company's definitive proxy statement relating to its 2000 annual meeting of stockholders filed with the SEC on April 20, 2000.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The information required by Item 12 is incorporated by reference to the Company's definitive proxy statement relating to its 2000 annual meeting of stockholders filed with the SEC on April 20, 2000.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information required by Item 13 is incorporated by reference to the Company's definitive proxy statement relating to its 2000 annual meeting of stockholders filed with the SEC on April 20, 2000.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

(a) 1. Financial Statements

The following financial statements and the Reports of Independent Public Accountants are filed as a part of this report on the pages indicated:

| | | |
|------|--|----|
| PAGE | | |
| | Consolidated Balance Sheets, at December 31, 1999 and 1998..... | 34 |
| | Consolidated Statements of Operations, for the years ended December 31, 1999, 1998, and 1997..... | 36 |
| | Consolidated Statements of Stockholders' Equity, for the years ended December 31, 1999, 1998, and 1997..... | 37 |
| | Consolidated Statements of Cash Flows, for the years ended December 31, 1999, 1998, and 1997..... | 38 |
| | Notes to Consolidated Financial Statements..... | 40 |

67

(a) 2. Exhibits

| NO. | DESCRIPTION |
|---------|--|
| --- | ----- |
| 3.1 (1) | Certificate of Incorporation of the Company. |
| 3.2 (2) | Certificate of Correction to the Certificate of Incorporation of the Company dated June 30, 1987. |
| 3.3 (2) | Certificate of Amendment to the Certificate of Incorporation of the Company dated June 30, 1987. |
| 3.4 (2) | Certificate of Amendment to the Certificate of Incorporation of the Company dated December 11, 1989. |
| 3.5 (2) | Certificate of Amendment to the Certificate of Incorporation of the Company dated December 14, 1989. |

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

- 3.6 (2) Bylaws of the Company.
- 3.7 (6) Certificate of Amendment to the Certificate of Incorporation of the Company dated December 8, 1997.
- 4.1 (2) Specimen Certificate of Blue Dolphin Energy Company Common Stock.
- * 10.1 (1) Blue Dolphin Energy Company 1985 Employee Stock Option Plan.
- * 10.2 (4) Blue Dolphin Energy Company 1996 Employee Stock Option Plan.
- 10.4 (3) Loan Agreement by and among Blue Dolphin Energy Company, Blue Dolphin Pipe Line Company, Buccaneer Pipe Line Co., Mission Energy, Inc. dba MEI Mission Energy, Inc., Ivory Production Co., Blue Dolphin Services Co., and Bank One, Texas, N. A., dated January 14, 1994.
- 10.6 (4) First Amendment to Loan Agreement dated January 14, 1994 by and among Blue Dolphin Energy Company, Blue Dolphin Pipe Line Company, Buccaneer Pipe Line Co., Mission Energy, Inc. d/b/a MEI Mission Energy, Inc., Ivory Production Co., Blue Dolphin Services Co., and Bank One, Texas, N.A., dated February 7, 1995.
- 10.7 (4) Second Amendment to Loan Agreement dated January 14, 1994 by and among Blue Dolphin Energy Company, Blue Dolphin Pipe Line Company, Buccaneer Pipe Line Co., Mission Energy, Inc. d/b/a MEI Mission Energy, Inc., Blue Dolphin Exploration Company, previously known as Ivory Production Co., Blue Dolphin Services Co., and Bank One, Texas, N. A., dated December 22, 1995.
- 10.8 (5) Third Amendment to Loan Agreement dated January 14, 1994 by and among Blue Dolphin Energy Company, Blue Dolphin Pipe Line Company, Buccaneer Pipe Line Co., Mission Energy, Inc. d/b/a MEI Mission Energy, Inc., Blue Dolphin Exploration Company, previously known as Ivory Production Co., Blue Dolphin Services Co., and Bank One, Texas, N. A., dated November 5, 1996.
- 10.9 Fourth Amendment to Loan Agreement dated January 14, 1994 by and among Blue Dolphin Energy Company, Blue Dolphin Pipe Line Company, Buccaneer Pipe Line Co., Mission Energy, Inc. d/b/a MEI Mission Energy, Inc., Blue Dolphin Exploration Company, previously known as Ivory Production Co., Blue Dolphin Services Co., and Bank One, Texas, N. A., dated August 18, 1998.
- 10.10 Fifth Amendment to Loan Agreement dated January 14, 1994 by and among Blue Dolphin Energy Company, Blue Dolphin Pipe Line Company, Buccaneer Pipe

68

Line Co., Mission Energy, Inc. d/b/a MEI Mission Energy, Inc., Blue Dolphin Exploration Company, previously known as Ivory Production Co., Blue Dolphin Services Co., and Bank One, Texas, N. A., dated December 17, 1999.
- 10.11 Sixth Amendment to Loan Agreement dated January 14, 1994 by and among Blue Dolphin Energy Company, Blue Dolphin Pipe Line Company, Buccaneer Pipe Line Co., Mission Energy, Inc. d/b/a MEI Mission Energy, Inc., Blue Dolphin Exploration Company, previously known as Ivory Production Co., Blue Dolphin Services Co., and Bank One, Texas, N. A., dated January 12, 2000.

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

- 10.12 (7) Asset Purchase Agreement between WBI Southern, Inc., Blue Dolphin Pipeline Company, Buccaneer Pipe Line Co. and Mission Energy, Inc.
- 10.13 (7) Purchase and Sale Agreement between Enron Pipeline Company, Black Marlin Energy Company and Blue Dolphin Energy Company.
- 10.14 (7) Asset Purchase Agreement between WBI Southern, Inc., Black Marlin Pipeline Company and Black Marlin Energy Company.
- 10.15 (7) Asset Purchase Agreement between MCNIC Offshore Pipeline & Processing Company, Black Marlin Pipeline Company and Black Marlin Energy Company.
- 10.16 (8) Investment Agreement, as amended, by and between American Resources Offshore, Inc. and Blue Dolphin Exploration Company.
- 10.17 Management Services Agreement by and between Fidelity Oil Holdings, Inc. and Blue Dolphin Exploration Company.
- 21.1** List of Subsidiaries of the Company.
- 23.1** Consent of Netherland, Sewell & Associates, Inc., independent petroleum engineers and geologists.
- 23.2** Consent of Ryder Scott Company, independent petroleum engineers.
- 27.1** Financial Data Schedule.

-
- (1) Incorporated herein by reference to Exhibits filed in connection with Registration Statement on Form S-4 of ZIM Energy Corp. filed under the Securities Act of 1933 (Commission File No. 33-5559).
 - (2) Incorporated herein by reference to Exhibits filed in connection with Form 10-K of Blue Dolphin Energy Company for the year ended December 31, 1989 under the Securities and Exchange Act of 1934, dated March 30, 1990 (Commission File No. 000-15905).
 - (3) Incorporated herein by reference to Exhibits filed in connection with Form 10-K of Blue Dolphin Energy Company for the year ended December 31, 1993 under the Securities and Exchange Act of 1934, dated March 30, 1994 (Commission File No. 000-15905).
 - (4) Incorporated herein by reference to Exhibits filed in connection with Form 10-K of Blue Dolphin Energy Company for the year ended December 31, 1995 under the Securities and Exchange Act of 1934, dated March 29, 1996 (Commission File No. 000-15905).
 - (5) Incorporated herein by reference to Exhibits filed in connection with Form 10-K of Blue Dolphin Energy Company for the year ended December 31, 1996 under the Securities and Exchange Act of 1934, dated March 31, 1997 (Commission File No. 000-15905).

69

- (6) Incorporated herein by reference to Exhibits filed in connection with the definitive Information Statement on Schedule 14C of Blue Dolphin Energy Company under the Securities and Exchange Act of 1934, dated November 18, 1997 (Commission File No. 000-15905).
- (7) Incorporated herein by reference to Exhibits filed in connection with Form 8-K of Blue Dolphin Energy Company under the Securities and Exchange Act of

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

1934, dated March 1, 1999 (Commission File No. 000-15905).

(8) Incorporated herein by reference to Exhibits filed in connection with Schedule 13D of Blue Dolphin Energy Company under the Securities and Exchange Act of 1934, dated October 22, 1999 (commissions File No. 000-15905).

* Management Compensation Plan.

** Previously filed.

*** Filed herewith.

(b) Reports on Form 8-K

On December 7, 1999, the Company filed a current report on Form 8-K dated December 2, 1999 that it closed the purchase of 39,509,457 shares of common stock of American Resources Offshore, Inc. The items reported in such current report were Item 2 (Acquisitions or Dispositions of Assets) and Item 7 (Financial Statement and Exhibits).

On December 17, 1999, the Company filed a current report on Form 8-KA dated December 17, 1999, with respect to the acquisition of American Resources Offshore, Inc. The items reported in such current report were Item 2 (Acquisitions or Dispositions of Assets) and Item 7 (Financial Statement and Exhibits).

70

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

BLUE DOLPHIN ENERGY COMPANY
(Registrant)

By: /S/ MICHAEL J. JACOBSON
Michael J. Jacobson, President
(principal executive officer)

Date: January 10, 2001

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

| SIGNATURE | TITLE | |
|--|--|------------------|
| Date | | |
| /S/ MICHAEL J. JACOBSON Michael J. Jacobson | President (principal executive officer) | January 10, 2001 |
| /S/ G. BRIAN LLOYD G. Brian Lloyd | Vice President, Treasurer (principal accounting and financial officer) | January 10, 2001 |
| /S/ IVAR SIEM Ivar Siem | Chairman | January 10, 2001 |

Edgar Filing: BLUE DOLPHIN ENERGY CO - Form 10-K405/A

/S/ HARRIS A. KAFFIE Director January 10, 2001
Harris A. Kaffie

/S/ ROBERT L. BARBANELL Director January 10, 2001
Robert L. Barbanell

/S/ MICHAEL S. CHADWICK Director January 10, 2001
Michael S. Chadwick