BLUE DOLPHIN ENERGY CO
Form 10QSB
August 15, 2005

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

FORM 10-QSB

[X] Quarterly Report Under Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended: JUNE 30, 2005

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

Commission File Number: 0-15905

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

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

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

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

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

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

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

As of August 15, 2005, there were 9,157,917 shares of the registrant's common stock, par value $.01 per share, outstanding.

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

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

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

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BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEET - UNAUDITED

June 30, 2005

ASSETS	
Current assets:	
Cash and cash equivalents	$ 870
Accounts receivable	298
Prepaid expenses and other assets	192
TOTAL CURRENT ASSETS	1,361
Property and Equipment, at cost:	
Oil and Gas properties, including $104,616 of unproved leasehold cost (full-cost method)	444
Pipelines	4,547
Onshore separation and handling facilities	1,664
Land	860
Other property and equipment	259
	7,775

Less: Accumulated depletion, depreciation, amortization and impairment	2,689
	5,085
Other Assets	11
TOTAL ASSETS	$ 6,459

LIABILITIES AND STOCKHOLDERS' EQUITY

Current Liabilities:	
Accounts payable	$ 597
Notes payable	750
Current portion of long-term debt	120
Accrued expenses and other liabilities	108
TOTAL CURRENT LIABILITIES	1,575
Long-term debt	560
Asset retirement obligations	1,670
Common Stock, ($.01 par value, 25,000,000 shares authorized, 9,123,287 shares issued and outstanding)	91
Additional Paid-in Capital	27,106
Accumulated Deficit	(24,544
TOTAL STOCKHOLDERS' EQUITY	2,652
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 6,459

See accompanying notes to the condensed consolidated financial statements.

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS - UNAUDITED

	Three Months Ended June 30	
	2005	
Revenue from operations:		
Pipeline operations	$ 327,093	$
Oil and gas sales	42,336	
Gain on sale of oil and gas property	--	
	369,429	
Cost of operations:		
Pipeline operating expenses	200,189	
Lease operating expenses	41,225	

Depletion, depreciation and amortizaton	85,056
General and administrative	495,059
Accretion expense	24,404
	845,933
LOSS FROM OPERATIONS	(476,504)
Other Income (expense):	
Interest and other expense	(41,184)
Interest and other income	2,892
Equity in loss of affiliate	--
LOSS BEFORE INCOME TAXES	(514,796)
Income taxes	--
Net loss	$ (514,796)
Loss per common share - basic and diluted	$ (0.06)
Weighted average number of common shares outstanding - basic and diluted	8,777,142

See accompanying notes to the condensed consolidated financial statements.

4

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS - UNAUDITED

	Six Mon Ended Ju
	2005
Revenue from operations:	
Pipeline operations	$ 648,708
Oil and gas sales	79,751
Gain on sale of oil and gas property	--
	728,459
Cost of operations:	
Pipeline operating expenses	488,049
Lease operating expenses	57,859
Depletion, depreciation and amortizaton	170,885
General and administrative	922,354
Accretion expense	48,809

	1,687,956
LOSS FROM OPERATIONS	(959,497)
Other Income (expense):	
Interest and other expense	(80,631)
Interest and other income	328,340
Equity in loss of affiliate	--
LOSS BEFORE INCOME TAXES	(711,788)
Income taxes	--
Net loss	$ (711,788)
Loss per common share - basic and diluted	$ (0.09)
Weighted average number of common shares outstanding - basic and diluted	7,871,972

See accompanying notes to the condensed consolidated financial statements.

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS - UNAUDITED

	Six Mo Ended Ju
	2005
OPERATING ACTIVITIES	
Net loss	$ (711,788)
Adjustments to reconcile net loss to net cash used in operating activities:	
Depletion, depreciation and amortization	170,885
Amortization of debt issue costs	27,501
Gain on sale of oil and gas property	(140,409)
Accretion of asset retirement obligations	48,809
Equity in loss of affiliate	--
Common stock issued for services	--
Gain on debt restructuring	(132,368)
Changes in operating assets and liabilities:	
Accounts receivable	17,389
Prepaid expenses and other assets	(26,523)
Accounts payable and other liabilities	(78,950)
NET CASH USED IN OPERATING ACTIVITIES	(825,454)

INVESTING ACTIVITIES	
Property, equipment and other assets	(7,192)
Proceeds from sale of assets	214,632
Development costs - New Avoca	--
NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES	207,440
FINANCING ACTIVITIES	
Payments on Borrowings	(70,000)
Financing costs	(2,275)
NET CASH USED IN FINANCING ACTIVITIES	(72,275)
DECREASE IN CASH AND CASH EQUIVALENTS	(690,289)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	1,560,549
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 870,260

See accompanying notes to the condensed consolidated financial statements

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
UNAUDITED
JUNE 30, 2005

1. LIQUIDITY

At June 30, 2005, our working capital deficit was approximately $200,000. Even though we continue to incur losses from operations due to the poor performance of our pipeline assets, we currently believe that we have sufficient resources in order to satisfy our working capital and capital expenditure requirements for the twelve months ending June 30, 2006. However, we must achieve positive operating results or acquire assets with positive cash flows in order to satisfy our cash requirements thereafter.

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

During April 2005, we arranged an extension of the maturity date and deferred the payment of interest on $450,000 aggregate principle amount of promissory notes we originally issued pursuant to the Note and Warrant Purchase Agreement dated September 8, 2004. Under the revised terms, these promissory notes will now mature on June 30, 2006 and all interest is deferred until maturity.

In July 2005, we entered into gas and condensate transportation and handling agreements with Manti Operating Company to deliver production through the Blue

Dolphin Pipeline System. Deliveries are expected to commence within 60 days. Volumes to be transported are not known at this time.

In early August 2005, we received notice that a contractual after-payout reversionary interest we retained in High Island Block 37 in the Gulf of Mexico has reached payout. At this time, we are uncertain of the amount that we will receive from this interest, however, we believe that the proceeds will be in excess of $500,000.

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

	Six Months Ended June 30, (amounts in thousands)	
	2005	2004
Net cash provided by (used in):		
Operating activities	$ (825)	$ (1,65
Investing activities	207	(1
Financing activities	(72)	-
Net decrease in cash	$ (690)	$ (1,67

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
UNAUDITED - CONTINUED
JUNE 30, 2005

2. CONTINGENCIES

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

3. EARNINGS PER SHARE

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

Employee stock options and stock warrants at June 30, 2005 and 2004 were not included in the computation of diluted earnings per share because the effect of their assumed exercise and conversion would have an antidilutive effect on the computation of diluted loss per share.

	Net Loss	Weighted-Average Number of Common Shares Outstanding and Potential Dilutiv Common Shares
Six Months ended June 30, 2005		
Basic and diluted loss per share	$ (711,788)	7,871,972
Six Months ended June 30, 2004		
Basic and diluted loss per share	$ (1,343,012)	6,688,082
Quarter ended June 30, 2005		
Basic and diluted loss per share	$ (514,796)	8,777,142
Quarter ended June 30, 2004		
Basic and diluted loss per share	$ (823,406)	6,712,438

8

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
UNAUDITED - CONTINUED
JUNE 30, 2005

4. BUSINESS SEGMENT INFORMATION

Our income producing operations are conducted in two principal business segments: pipeline transportation services and oil and gas exploration and production. There were no intersegment revenues during the periods presented. Information concerning these segments for the six months and three months ended June 30, 2005 and 2004, and at June 30, 2005 are as follows:

	Revenues	Operating Loss(*)
Six months ended June 30, 2005		
Pipeline operations	$ 648,708	(613,326)
Oil and gas exploration and production	79,751	(58,179)
Other	--	(287,992)
Consolidated	728,459	(959,497)
Other income (loss), net		247,709
Loss before income taxes		(711,788)

Six months ended June 30, 2004		
Pipeline operations	$ 397,537	(800,888)
Oil and gas exploration and production	281,170	(121,170)
Other	--	(312,184)
Consolidated	678,707	(1,234,242)
Other income (loss), net		(108,770)
Loss before income taxes		(1,343,012)
Quarter ended June 30, 2005		
Pipeline operations	$ 327,093	(263,722)
Oil and gas exploration and production	42,336	(42,121)
Other	--	(170,661)
Consolidated	369,429	(476,504)
Other income (loss), net		(38,292)
Loss before income taxes		(514,796)
Quarter ended June 30, 2004		
Pipeline operations	$ 193,498	(482,974)
Oil and gas exploration and production	126,278	(57,293)
Other	--	(123,664)
Consolidated	319,776	(663,931)
Other income (loss), net		(159,475)
Loss before income taxes		(823,406)

9

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
UNAUDITED - CONTINUED
JUNE 30, 2005

	June 30, 2005
Identifiable assets:	
Pipeline operations	$ 5,712,683
Oil and gas exploration and production	260,424
Other	486,063
Consolidated	$ 6,459,170

(*) Consolidated loss from operations includes $283,207 and $306,136 in unallocated general and administrative expenses, and unallocated depletion, depreciation and amortization of $4,785 and $6,048 for the six months ended June 30, 2005 and 2004, respectively. All unallocated amounts are included in "Other."

Consolidated loss from operations includes $168,460 and $120,809 in unallocated general and administrative expenses, and unallocated depletion, depreciation and amortization of $2,201 and $2,855 for the quarters ended June 30, 2005 and 2004, respectively. All unallocated amounts are included in "Other."

5. STOCK BASED COMPENSATION

We account for stock-based compensation granted under our long-term incentive plans using the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" and related interpretations. Stock-based compensation expenses associated with option grants were not recognized in our net loss in the six months and three months ended June 30, 2005 and 2004, as all options granted had exercise prices equal to the market value of the underlying common stock on the dates of grant. The following table illustrates the effect on net loss and loss per share if we had applied the fair value recognition provisions of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" to stock-based employee compensation:

	Three months ended June 30,	
	2005	2004
	(in thousands, except	
Net loss, as reported	$ (515)	$ (823)
Add: Total stock-based employee compensation included in reported net loss, net of related tax effects	--	--
Deduct: Total stock-based employee compensation expense determined under fair value based method for awards, net of related tax effects	--	--
Pro forma net loss	$ (515)	$ (823)
Net loss per share:		
Basic and Diluted - as reported	$ (0.06)	$ (0.12)
Basic and Diluted - pro forma	$ (0.06)	$ (0.12)

During the six months ended June 30, 2005, 236,821 stock options were exercised, with exercise prices ranging from $.35 per share to $1.90 per share. All of the stock options exercised were done so by using the quoted market value of the shares of common stock issued to pay the option exercise price. As a result, 51,259 shares of common stock issued were surrendered to us for payment of the option exercise price. At June 30, 2005 there were 199,497 stock options outstanding with exercise prices ranging from $.35 per share to $6.00 per share.

6. EXERCISE OF WARRANTS

As of January 1, 2005, there were 3,100,000 warrants outstanding that were issued pursuant to the Note and Warrant Purchase Agreement dated September 8, 2004. During the six months ended June 30, 2005, 2,291,671 warrants were exercised.

The exercise of the warrants was accomplished via net exercises, whereby holders surrendered their right to purchase a portion of the shares of common stock, resulting in 217,637 shares of common stock being surrendered to us for payment of the warrant exercise price and 2,074,034 shares issued to warrant holders.

As of the filing of this report, there were 808,329 warrants outstanding. The outstanding warrants are fully vested, exercisable at $.25 per warrant into one share of common stock, and expire between September 8, 2009 and November 30, 2009.

7. RECENT ACCOUNTING DEVELOPMENTS

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

The FASB has issued FASB Statement No. 154, Accounting Changes and Error Corrections. This new standard replaces APB Opinion No. 20, Accounting Changes, and FASB Statement No. 3, Reporting Accounting Changes in Interim Financial Statements, and represents another step in the FASB's goal to converge its standards with those issued by the IASB. Among other changes, Statement 154 requires that a voluntary change in accounting principle be applied retrospectively with all prior period financial statements presented on the new accounting principle, unless it is impracticable to do so. Statement 154

also provides that (1) a change in method of depreciating or amortizing a long-lived non-financial asset be accounted for as a change in estimate (prospectively) that was effected by a change in accounting principle, and (2) correction of errors in previously issued financial statements should be termed a "restatement." The new standard is effective for accounting changes and correction of errors made in fiscal years beginning after December 15, 2005.

On March 30, 2005, FASB Interpretation (FIN) No. 47, Accounting for Conditional Asset Retirement Obligations - An Interpretation of FASB Statement No. 143, was issued. The FASB issued FIN 47 to address diverse accounting practices that developed with respect to the timing of liability recognition for legal obligations associated with the retirement of a tangible long-lived asset when the timing and (or) method of settlement of the obligation are conditional on a future event. For example, some entities recognize the fair value of the obligation prior to the retirement of the asset with the uncertainty about the timing and (or) method of settlement incorporated into the fair value of the liability. Other entities recognize the fair value of the obligation only when it is probable the asset will be retired as of a specified date using a specified method or when the asset is actually retired. FIN 47 concludes that an entity is required to recognize a liability for the fair value of a conditional asset retirement obligation when incurred if the liability's fair value can be reasonably estimated.

We are currently assessing the impact on our consolidated financial statements of all the recent accounting developments discussed above in this note.

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BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

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

CAUTIONARY NOTE REGARDING FORWARD LOOKING STATEMENTS

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

- the level of utilization of our pipelines;
- availability and cost of capital;

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

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

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

EXECUTIVE SUMMARY

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

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

- Implemented cost savings measures that included, among other things, reducing the number of employees and contract personnel,

- Extended the payment terms of $668,000 of indebtedness that was due in August and September 2004,

- Raised capital through the issuance of $750,000 of promissory notes in September 2004,

- Sold our interest in New Avoca Gas Storage, LLC for approximately $930,000 in October 2004, and

- Negotiated an increase in gas transportation rates on the Blue Dolphin System effective October 2004,

As a result of our ongoing liquidity problems, our independent, registered public accounting firm, UHY Mann Frankfort Stein & Lipp CPAs, LLP added an explanatory paragraph in their opinion on our consolidated financial statements as of the year ended December 31, 2004, indicating that substantial doubt exists about our ability to continue as a going concern. Although we took certain steps in 2004 to address our liquidity shortage and improve our financial performance at the beginning of 2005, we estimated that we would need to raise approximately $500,000 to satisfy our liquidity and working capital requirements through 2005. At June 30, 2005 we had a working capital deficit of $200,000. To address our liquidity shortage in 2005 we:

- Extended the maturity date and deferred interest payments on $450,000 aggregate principal amount of promissory notes issued in September 2004, and

- Restructured the terms of our indebtedness to MCNIC Pipeline and Processing Group, Inc. ("MCNIC") by reducing the principal amount of the indebtedness to $250,000 and having all accrued and unpaid interest forgiven.

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

We were also recently notified that payout has occurred on our after-payout reversionary interest in High Island Block 37. At this point we are not able to determine the exact amount that we are due, however, we believe that it will be in excess of $500,000. Absent receipt of these funds we believe we have sufficient liquidity to satisfy our working capital requirements through June 30, 2006.

LIQUIDITY AND CAPITAL RESOURCES

While we have been able to implement cost savings measures and restructure the terms of some of our indebtedness we were not able to generate sufficient cash from operations to cover operating costs and general and administrative expenses. For the six months ended June 30, 2005, we generated total revenues of approximately $728,000 while operating costs and general administrative expenses totaled approximately $1,468,000 and a working capital deficit of approximately $200,000. Our financial condition has been significantly and negatively affected by the poor performance of our businesses and our significant indebtedness.

On February 28, 2005 (effective as of January 1, 2005), we entered into an amendment to our purchase agreement with MCNIC. Under the terms of the original purchase agreement, we acquired MCNIC's one-third interests in both the Blue Dolphin System and the inactive Omega Pipeline. Pursuant to the terms of the amendment, the original promissory note was exchanged for a new promissory note in the principal amount of $250,000, and all accrued interest on the original promissory note was forgiven, approximately $132,000. We made a principal payment on the new promissory note of $30,000 upon the execution of the amendment. Under the terms of the new promissory note, we will make monthly principal payments of $10,000 through its maturity date of December 31, 2006. In addition, MCNIC may receive additional payments of up to $500,000 from 50% of the net profits, if any, realized from the one-third interest in the Blue Dolphin System through December 31, 2006, and the principal amount of the new promissory note may be increased by up to $500,000, if 50% or more of our 83% interest in the Blue Dolphin System is sold before December 31, 2006.

In July 2005, we entered into gas and condensate transportation and handling contracts with Manti Operating Company to deliver production into the Blue Dolphin Pipeline System in Galveston area state tract 348. We expect to begin providing services related to these contracts in at the end of the third quarter or the beginning of the fourth quarter. The amount of revenue derived from these contracts will be based on the volume of gas or condensate that we transport, which we cannot predict at this time.

On August 1, 2005, we made our final payment to Tetra Applied Technologies, Inc. ("Tetra"). In August 2004, we restructured our indebtedness to Tetra for the abandonment/reefing of the Buccaneer Field. Under the revised terms, on September 1, 2004 we began paying Tetra the outstanding balance in twelve monthly installments of $55,667 plus interest on the outstanding balance at the rate of six percent per annum. At June 30, 2005, the remaining balance due Tetra was approximately $111,000.

On September 8, 2004, we entered into a Note and Warrant Purchase Agreement ("Purchase Agreement") with certain accredited investors and certain of our directors for the purchase and sale of promissory notes in an aggregate principal amount of $750,000 (the "Promissory Notes") and 2,800,000 warrants ("Warrants") to purchase shares of our common stock at a purchase price of $0.003 per Warrant. We

received proceeds of $758,400 from the issuance of the Promissory Notes and the Warrants. The Promissory Notes mature on September 8, 2005, and accrue interest at a rate of 12.0% per annum, of which 4% is payable monthly and 8% is payable at maturity. However, in April 2005, the holders of $450,000 aggregate principal amount of Promissory Notes agreed to extend the maturity date of their Promissory Notes to June 30, 2006 and to defer the payment of all interest on their Promissory Notes until maturity. As of June 30, 2005, we have issued 2,074,034 shares of common stock as a result of the exercise of Warrants. The exercise of the Warrants was accomplished via net exercises, whereby holders surrendered their right to receive 217,637 shares of common stock.

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

The following table summarizes certain of our contractual obligations and other commercial commitments at June 30, 2005 (amounts in thousands):

Contractual Obligations and Other Commercial Commitments	Payments Due by Period Total	1 year or less	1-3 years	3-5
Accounts Payable - Tetra	$ 111	111	-	
Notes Payable and Long-Term Debt	1,484	924	560	
Operating Leases, net of sublease	205	123	70	
Abandonment - Costs	1,671	-	194	
Total Contractual Obligations and Other Commercial Commitments	$ 3,471	1,158	824	

16

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

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

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

	June 30, 2005 Amount	%	December 31, 2004 Amount	%
Working Capital	$ (214)	(4)	$ 404	7
Property and equipment, net	5,086	104	5,324	93
Other noncurrent assets	11	--	11	--
Total	$ 4,883	100	$5,739	100
Long-term Liabilities	$ 2,230	46	$2,374	41
Stockholders' equity	2,653	54	3,365	59
Total	$ 4,883	100	$5,739	100

Our financial condition continues to be adversely affected by the poor performance or our business and we have not been able to generate sufficient cash from operations to cover operating costs and general and administrative expenses. Natural gas transportation throughput on our Blue Dolphin System is currently 6 MMBtu per day representing approximately 4% of system capacity. However, we believe, that the Blue Dolphin System is in a market area that is experiencing an increased level of interest by oil and gas operators based on the recent leasing activity in the lease blocks surrounding the pipelines. Effective October 1, 2004, we renegotiated the gas transportation rates on the Blue Dolphin System due to operating losses incurred from operating the system. As a result, gas transportation revenues from the Blue Dolphin System for the first half of 2005 totaled approximately $436,000. Without the increased rates, gas transportation revenues would have been approximately $121,000 for this same period. Future utilization of our pipelines and related facilities will depend upon the success of drilling programs around our pipeline systems, and attraction and retention of producer/shippers to the systems. Three new successful wells have recently been drilled in lease blocks in the vicinity of the Blue Dolphin Pipeline. We have entered into transportation and handling agreements with the operator of one of the wells and are currently negotiating with the operators of the other two wells. As a result of current and anticipated drilling activity around the Blue Dolphin System, we expect that utilization of the Blue Dolphin System will increase in late 2005.

During the six months ended June 30, 2005, we incurred no capital expenditures for the development of our proved reserves. However, we do expect to make capital expenditures totaling $40,000 and $203,000 in the years ending December 31, 2005 and 2007, respectively. Capital expenditures in 2005 represent workover costs, net to our interest, for the producing well in the High Island Block A-7 field and in 2007, the abandonment costs of our High Island Block A-7 field, net to our interest.

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

RESULTS OF OPERATIONS

We reported a net loss for the six months ended June 30, 2005 ("current period") of $711,788 compared a net loss of $1,343,012 reported for the six months ended June 30, 2004 ("previous period"). For the three months ended June 30, 2005 ("current quarter"), we reported a net loss of $514,796, compared to a net loss of $823,406 for the three months ended June 30, 2004 ("previous quarter").

FIRST HALF OF 2005 COMPARED TO FIRST HALF OF 2004

Revenue from pipeline operations. Revenues from pipeline operations increased by $251,171 or 63% in the current period to $648,708. Revenues in the current period from the Blue Dolphin System totaled approximately $521,000 compared to approximately $254,000 in the previous period primarily as a result of an increase in our average gas transportation rates on the Blue Dolphin System effective as of October 2004. The increased rates will decrease as our net operating results from the Blue Dolphin System improve, but in any case, the rates will be no lower than the rates that were in effect prior to October 2004.

Revenue from oil and gas sales. Revenues from oil and gas sales decreased by $201,419 to $79,751 in the current period from those of the previous period primarily due to a significant production decline in the High Island Block A-7 field, which provided revenues from oil and gas sales of approximately $80,000 in the current period compared to approximately $217,000 in the previous period. We expect that revenue from oil and gas sales will continue to decline as we anticipate that production from the reservoir currently producing will cease in the third quarter of 2005. However there is an additional reservoir in which a recompletion in the existing well is possible. Oil and gas sales from this additional reservoir are not expected to significantly increase our total revenues in 2005. Previous period oil and gas sales include approximately $64,000 from our interest in the High Island Block 34 field, which was sold in June 2004.

Pipeline operating expenses. Pipeline operating expenses in the current period decreased by $160,483 to $488,049 due to lower repairs and maintenance costs of approximately $170,000 and lower insurance costs of approximately $85,000, partially offset by an increase in legal costs of approximately $52,000. The decrease in insurance costs is due to a refund received for having no claims in the previous policy period and the elimination of property insurance coverage on our pipelines. The increase in legal costs is associated with an ongoing action against us, the outcome of which we do not believe will have a material impact. However, as this litigation continues we will continue to incur significant legal expenses which could have a material adverse effect on our financial condition.

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

General and administrative. General and administrative expenses increased by $26,113 to $922,354 in the current period. The increase was due to higher legal and consulting expenses associated with our efforts to raise capital, offset by lower personnel and other costs as a result of our cost reduction plans implemented in 2003 and 2004. The 2004 cost reductions included the termination of certain employees in mid 2004. The annual cost savings associated with measures taken is expected to be approximately $360,000. However, if our business activities expand, we will need to hire additional employees, and our personnel and associated costs may increase.

Depletion, depreciation and amortization. Depletion, depreciation and amortization expense decreased by $83,623 in the current period to $170,885. In the previous period we recorded depletion of approximately $63,000 associated with our oil and gas properties. The decrease in depletion was a result of there being no remaining unamortized oil and gas costs in the current period.

Interest and other expense. Interest and other expense decreased $145,031 in the current period. Other expense in the prior period includes approximately $200,000 in legal and other fees associated with a proposed financing transaction that was subsequently terminated, offset by increased interest expense in the current period of approximately $29,000, and amortization of debt issuance costs of approximately $28,000 due to the issuance of the Promissory Notes in September 2004.

Interest and other income. Interest and other income increased $188,887 in the current period. Other income in the current period includes a gain on the placement of our interests in the Galveston Block 287/297 leases of approximately $140,000, a gain on the elimination of accrued interest pursuant to the restructuring of the MCNIC promissory note of approximately $132,000 and the collection of accounts receivable that were previously written off of approximately $45,000. Other income in the previous period includes fees generated for consulting services we provided, associated with the evaluation of oil and gas properties of $50,000 and the collection of accounts receivable that were previously written off of $75,000.

Equity in loss of affiliate. In the previous period we recorded a loss from our equity interest in New Avoca of $48,370. Our interest in New Avoca was sold in October 2004.

SECOND QUARTER OF 2005 COMPARED TO SECOND QUARTER OF 2004

Revenue from pipeline operations. Revenues from pipeline operations increased by $133,595 or 69% in the current quarter to $327,093. Revenues in the current quarter from the Blue Dolphin System totaled approximately $267,000 compared to approximately $130,000 in the previous quarter primarily as a result of an increase in our average gas transportation rates on the Blue Dolphin System effective as of October 2004.

Revenue from oil and gas sales. Revenues from oil and gas sales decreased by $83,942 in the current quarter from those of the previous quarter primarily due to a significant production decline in the High Island Block A-7 field, which provided revenues from oil and gas sales of approximately $42,000 in the current quarter compared to approximately $99,000 in the previous quarter. Oil and gas sales in the previous quarter include approximately $28,000 from our interest in the High Island Block 34 field, which was sold in June 2004.

Pipeline operating expenses. Pipeline operating expenses in the current quarter decreased by $205,092 to $200,189 due to lower repairs and maintenance costs of approximately $170,000 and lower legal costs of approximately $41,000. The legal costs are associated with an ongoing action against us, the outcome of which we do not believe will have a material impact.

General and administrative. General and administrative expenses increased by $94,832 to $495,059 in the current quarter. The increase was due to higher legal and consulting expenses associated with our efforts to raise capital, offset by lower personnel and other costs as a result of our cost reduction plans implemented in 2003 and 2004.

Depletion, depreciation and amortization. Depletion, depreciation and amortization expense decreased by $34,670 in the current quarter to $85,056. In the previous quarter we recorded depletion of approximately $25,000 associated with our oil and gas properties. The decrease in depletion was a result of there being no remaining unamortized oil and gas costs in the current quarter.

Interest and other expense. Interest and other expense decreased $172,776 in the current quarter. Other expense in the prior quarter includes approximately $200,000 in legal and other fees associated with a proposed financing transaction that was subsequently terminated, partially offset by increased interest expense and amortization of debt issuance costs in the current quarter due to the issuance of the Promissory Notes in September 2004.

Interest and other income. Interest and other income decreased $50,852 in the current quarter Other income in the previous quarter includes $45,000 associated with the collection of accounts receivable that were previously written off .

Equity in loss of affiliate. In the previous quarter we recorded a loss from our equity interest in New Avoca of $25,068. Our interest in New Avoca was sold in October 2004.

RECENT ACCOUNTING DEVELOPMENTS

See Note 7 in Item 1.

ITEM 3. CONTROLS AND PROCEDURES

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Principal Accounting Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act). Based upon the evaluation, the Chief Executive Officer and Principal Accounting Officer concluded that our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act, are recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms. There were no changes in our internal controls as of the end of the period covered by this report; however, there were changes in our internal controls over financial reporting, in the form of more in-depth project status review procedures that occurred subsequent to the period, and up to the date of this filing. These changes were designed to enhance our existing controls and procedures.

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PART II. OTHER INFORMATION

ITEM 2. UNREGISTERED SALES OF SECURITIES AND USE OF PROCEEDS

From April 21, 2005 through June 6, 2005, 583,336 outstanding warrants were exercised by warrant holders. The exercises were accomplished via net exercise, whereby holders surrender their right to receive a portion of the shares of common stock. The rights to receive 68,562 shares of common stock were surrendered and the Company issued 514,774 shares of common stock upon exercise.

From June 1, 2005 through June 3, 2005, 80,571 stock options were exercised. These options were granted under the Blue Dolphin 2000 Stock Incentive Plan. The exercises were accomplished via net exercise, as described above. The stock options had exercise prices from $.35 per share to $1.90 per share. The rights to receive 23,548 shares were surrendered, and the Company issued 57,023 shares of common stock upon exercise.

These securities were issued in reliance upon the exemption from registration pursuant to Section 4(2) under the Securities Act of 1933, as amended.

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

The Company's annual meeting of stockholders was held on May 19, 2005. The matter that was voted upon at the meeting, and the number of votes cast for or against, as well as the number of abstentions as to such matter, where applicable, are set forth below.

	Votes For	Votes Against	Abstentions
Election of Directors			
Ivar Siem	5,482,728	33,563	22,457
Laurence N. Benz	5,477,011	39,380	22,357
Michael S. Chadwick	3,731,067	1,785,324	22,357
Harris A. Kaffie	5,489,891	26,500	22,357
F. Gardner Parker	5,383,126	133,265	22,357
James M. Trimble	5,491,163	25,228	22,357

ITEM 6. EXHIBITS

A) Exhibits

3.1(1) Amended and Restated Certificate of Incorporation of the Company.

3.2(2) Amended and Restated Bylaws of the Company.

31.1 Ivar Siem Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Gregory W. Starks Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Ivar Siem Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002.

32.2	Gregory W. Starks Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002.

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(1) Incorporated herein by reference to Exhibits filed in connection with the definitive Proxy Statement of Blue Dolphin Energy Company under the Securities and Exchange Act of 1934, dated October 13, 2004 (Commission File No. 000-15905).

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

23

BLUE DOLPHIN ENERGY COMPANY AND SUBSIDIARIES

SIGNATURES

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

By: BLUE DOLPHIN ENERGY COMPANY

Date: August 15, 2005

/s/ Ivar Siem

Ivar Siem
Chairman and Chief Executive Officer

/s/ Gregory W. Starks

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

24

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