

BLUE DOLPHIN ENERGY CO
Form 10-K
March 31, 2014

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

—
FORM 10-K

(Mark One)

- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2013

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 No. 0-15905

BLUE DOLPHIN ENERGY COMPANY
(Exact name of registrant as specified in its charter)

Delaware
State or other jurisdiction of
incorporation or organization

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

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

77002
(Zip Code)
(713) 568-4725

Registrant's telephone number, including area code

Securities registered pursuant to Section 12(b) of the Act:

Title of each class
Common Stock, par value \$0.01 per share

Name of each exchange on which registered
OTCQX

Securities registered pursuant to Section 12(g) of the Act:

(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes No

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Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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 whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of 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.

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller Reporting Company

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

The aggregate market value of shares of common stock held by non-affiliates of the registrant was \$8,843,968 based on the number of shares of common stock held by non-affiliates and the last reported sale price of the registrant's common stock on December 31, 2013.

Number of shares of common stock, par value \$0.01 per share outstanding as of March 31, 2014: 10,430,973

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FORWARD LOOKING STATEMENTS

As provided by the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, certain statements included throughout this Annual Report on Form 10-K, and in particular under the sections entitled “Part I, Item 1. Business,” “Part I, Item 3. Legal Proceedings” and “Part II, Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations” relating to matters that are not historical fact are forward-looking statements that represent management’s beliefs and assumptions based on currently available information. Forward-looking statements relate to matters such as our industry, business strategy, goals and expectations concerning our market position, future operations, margins, profitability, capital expenditures, liquidity and capital resources and other financial and operating information. We have used the words “anticipate,” “assume,” “believe,” “budget,” “continue,” “could,” “estimate,” “intend,” “may,” “plan,” “potential,” “predict,” “project,” “will,” “future” and similar terms and phrases to identify forward statements.

Forward-looking statements reflect our current expectations regarding future events, results or outcomes. These expectations may or may not be realized. Some of these expectations may be based upon assumptions or judgments that prove to be incorrect. In addition, our business and operations involve numerous risks and uncertainties, many of which are beyond our control, which could result in our expectations not being realized, or materially affect our financial condition, results of operations and cash flows.

Actual events, results and outcomes may differ materially from our expectations due to a variety of factors. Although it is not possible to identify all of these factors, they include, among others, the following:

- changes in the general economic conditions;
- changes in the underlying demand for our products;
- fluctuations of crude oil inventory costs and refined petroleum products inventory prices and their effect on our refining margins;
- our dependence on Genesis Energy, LLC (“Genesis”) and its affiliates for continued financing, sourcing of crude oil inventory and marketing of our refined petroleum products;
- the early termination of our agreements with Genesis and its affiliates;
- our dependence on Lazarus Energy Holdings, LLC (“LEH”) for continued financing and management of all of our subsidiaries and the operation of all of our assets, including the Nixon Facility, pursuant to the Management Agreement;
- our ability to generate sufficient funds from operations or obtain financing from other sources;
- failure to comply with certain financial covenants related to certain of our long-term indebtedness;
- regulatory changes that reduce the allowable sulfur content for commercially sold diesel in the United States, which will require us to incur significant capital upgrades and could have a material adverse effect on our results of operations, financial condition and cash flows;
- availability and cost of renewable fuels for blending and Renewable Identification Numbers (“RINs”) to meet Renewable Fuel Standards (“RFS”) obligations;
- strict laws and regulations regarding employee and business process safety to which we are subject, the compliance failure of which could have a material adverse effect on our results of operations and financial condition;
- potential increased indebtedness, which may reduce our financial flexibility;
- regulatory restrictions on greenhouse gas emissions, which could force us to incur increased capital and operating costs and could have a material adverse effect on our results of operations and financial condition;
- access to less than desired levels of crude oil for processing at the Nixon Facility;
- our dependence on a small number of customers for a large percentage of our revenues;

accidents, interruptions in transportation, inclement weather or other events that can cause unscheduled shutdowns or otherwise adversely affect our operations;

potential downtime of the Nixon Facility, which could result in lost margin opportunity, increased maintenance expense, increased inventory, and a reduction in cash available for payment of our obligations;

the geographic concentration of the Nixon Facility, which creates a significant exposure risk to the regional economy;

competition from larger companies;

infrastructure limitations;

dangers inherent in our operations, such as fires and explosions, which could cause disruptions and expose us to potentially significant losses, costs and liabilities and significantly reduce our liquidity;

the effects of Genesis' hedging of our refined petroleum products and crude oil inventory and exposure to the risks associated with volatile crude oil prices;

retention of key personnel;

insurance coverage that may be inadequate or expensive;

our potential reorganization from a publicly traded "C" corporation to a publicly traded master limited partnership;

performance of third-party operators for our oil and gas properties;

costs associated with abandonment of our pipelines and oil and gas properties; and

changes in and compliance with taxes, which could adversely affect our performance.

Any one of these factors or a combination of these factors could materially affect our future results of operations and could influence whether any forward-looking statements ultimately prove to be accurate. Our forward-looking statements are not guarantees of future performance, and actual results and future performance may differ materially from those suggested in any forward-looking statements. We do not intend to update these statements unless we are required by the securities laws to do so.

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PART I

ITEM 1. BUSINESS

Company Overview

Blue Dolphin Energy Company (www.blue-dolphin-energy.com), a Delaware corporation (referred to herein, with its predecessors and subsidiaries, as “Blue Dolphin,” “BDEC,” “we,” “us” and “our”) was formed in 1986 as a holding company. We conduct substantially all of our operations through our wholly-owned subsidiaries. We are primarily an independent refiner and marketer of petroleum products. Our primary asset is a 56 acre crude oil and condensate processing facility, which is located in Nixon, Wilson County, Texas (the “Nixon Facility”). As part of our refinery business segment we also conduct petroleum storage and terminaling operations under third-party lease agreements at the Nixon Facility. We also own and operate pipeline assets and have leasehold interests in oil and gas properties.

Refinery Operations

Our primary business is the refining of crude oil and condensate into marketable finished and intermediate products at the Nixon Facility, which has a current operating capacity of approximately 15,000 barrels (“bbls”) per day (“bpd”). The Nixon Facility consists of a distillation unit, naphtha stabilizer unit, depropanizer unit, jet fuel treater, approximately 120,000 bbls of crude oil storage capacity, approximately 148,000 bbls of refined product storage capacity and related loading and unloading facilities and utilities.

The Nixon Facility is operated as a “topping unit,” processing light crude oil and condensate primarily from the Eagle Ford Shale formation in South Texas. We purchase the light crude oil and condensate for the Nixon Facility under an exclusive supply agreement with GEL TEX Marketing, LLC (“GEL”), an affiliate of Genesis. The light crude oil and condensate is refined into finished products such as diesel and jet fuel and intermediate products such as naphtha, liquefied petroleum gas (“LPG”) and atmospheric gas oil. Finished products are sold in nearby markets and intermediate products are sold to wholesalers and nearby refineries for further blending and processing. Crude oil and condensate is currently received at the Nixon Facility by truck, however, the facility has the ability to receive feedstock by pipeline. Our refined products are sold and delivered primarily by truck.

Crude Oil Refining Industry Overview

Crude oil refining is the process of separating the hydrocarbons present in crude oil into usable or refined petroleum products such as gasoline, diesel, jet fuel and other products. The crude oil refining process for most refineries involves numerous stages to create refined products, however, as a “topping unit” the Nixon Facility only engages in the first stage of the crude oil refining process. Refining is primarily a margin-based business where the crude oil (and other feedstocks) and refined products are commodities with fluctuating prices. In order to increase profitability, it is important for a refinery to both maximize and optimize the yields of its most profitable products and minimize the costs of crude oil (and other feedstocks) and operating expenses, and to do so without compromising safety and environmental performance. According to the U.S. Energy Information Administration (the “EIA”), as of January 1, 2013, there were 139 oil refineries operating in the United States, 27 of which were in Texas. Crude oil supply and demand dynamics can vary by region, creating differentiated margin opportunities depending on a given refinery’s location.

Refinery Raw Material Supply

Crude oil and condensate derived from surrounding Eagle Ford Shale production currently comprises 100% of the Nixon Facility’s input. In August 2011, we entered into the Crude Oil Supply and Throughput Services Agreement (the “Crude Supply Agreement”) with GEL whereby we exclusively obtain all of the crude oil and condensate for the

Nixon Facility through GEL, other than the crude oil and condensate purchased from any other supplier with the prior consent of GEL. All crude oil and condensate supplied pursuant to the Crude Supply Agreement is paid for pursuant to the terms of the Joint Marketing Agreement as described herein (see “Part II, Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations – Relationship with Genesis”). In addition, we have granted GEL right of first refusal to use three storage tanks at the Nixon Facility during the term of the Crude Supply Agreement.

Subject to certain termination rights, the Crude Supply Agreement has an initial term of three years expiring on August 12, 2014. On October 30, 2013, Lazarus Energy, LLC (“LE”) entered into a Letter Agreement Regarding Certain Advances and Related Agreements with GEL and Milam Services, Inc. (“Milam”)(the “October 2013 Letter Agreement”), effective October 24, 2013. In accordance with the terms of the October 2013 Letter Agreement, LE agreed not to terminate the Crude Supply Agreement and GEL agreed to automatically renew the Crude Supply Agreement at the end of the initial term for successive one year periods until August 12, 2019 unless sooner terminated by GEL with 180 days prior written notice.

Refinery Customers

Customers for our finished and intermediate petroleum products include distributors, wholesalers and refineries primarily in the lower portion of the Texas Triangle (the Houston - San Antonio - Dallas/Fort Worth area). We have bulk term contracts in place with most of our customers. Many of these arrangements are subject to periodic renegotiation, which could result in us receiving higher or lower relative prices for our finished and intermediate petroleum products. For the year ended December 31, 2013, our five largest customers accounted for approximately 92% of our refined petroleum products sales. For the year ended December 31, 2012, our four largest customers accounted for approximately 84% of our refined petroleum products sales.

Petroleum Refining Market and Competition

The petroleum refining and marketing industry continues to be highly competitive. Many of our principal competitors are integrated, multi-national oil companies (e.g., Valero, Chevron, ExxonMobil, Shell and ConocoPhillips) and other major independent refining and marketing entities that operate in our market areas. The principal competitive factors affecting us are crude oil and other feedstock costs, refinery efficiency, operating costs, refinery product mix and product distribution/transportation costs. Because of their diversity, integration of operations and larger capitalization, these competitors may be better able to withstand volatile market conditions, compete on the basis of price, obtain crude oil in times of shortage and bear the economic risk inherent in all phases of the refining industry due to their geographic diversity, operational complexity and resources.

We operate primarily in the Eagle Ford Shale in South Texas supplying finished and intermediate petroleum products to the area from our Nixon Facility. The market for our finished and intermediate petroleum products is generally supplied by a number of refiners, including large integrated oil companies or independent refiners. These larger companies typically have greater resources and may have greater flexibility in responding to volatile market conditions or absorbing market changes.

Refinery Operations Business Strategy

We are dedicated to maintaining safe, efficient and reliable refinery operations, improving liquidity and profitability, and focusing on safety and environmental stewardship. Throughout 2013, we took a number of steps to more effectively operate the Nixon Facility and manage the spread between our cost to acquire crude oil and the price of the refined petroleum products that we ultimately sell, as follows:

Safety and Environmental Management – We implemented programs and procedures across the company for managing safety and environmental matters with a focus on the assignment of responsibilities, sound risk management and decision-making, efficient and cost-effective planning and operations and regulatory compliance. We also completed an assessment of process safety management (“PSM”) standards at the Nixon Facility. Improving our PSM standards and developing a PSM program at the Nixon Facility, which is designed to address all aspects of OSHA guidelines for developing and maintaining a comprehensive PSM program., is an integral part of our safety and environmental management strategy going forward;

Improved Product Mix – The Nixon Facility began producing jet fuel – the Nixon Facility’s fifth commercially saleable product – in mid-September 2013. Jet fuel is produced by separating the distillate stream into kerosene and diesel and blending the kerosene with a portion of the heavy naphtha stream. Production of jet fuel, which is considered a higher value product, significantly upgrades the value of the naphtha component. We plan to significantly increase the production of jet fuel during 2014;

Naphtha Stabilizer and Depropanizer Units Refurbishment – We continued the refurbishment of certain components of Nixon Facility, including the naphtha stabilizer and depropanizer units, which we anticipate will: (i) improve the overall quality of the naphtha that we produce, (ii) allow higher recovery of lighter products that can be sold as a liquefied petroleum gas (“LPG”) mix, and (iii) increase the amount of throughput that can be processed by the Nixon Facility. The estimated cost to refurbish the naphtha stabilizer and depropanizer units is approximately \$1.5 million; and

Nixon Facility Improvements -- We continued to enhance our condition-based predictive maintenance turnaround policy and completed several smaller capital improvement projects at the Nixon Facility, such as installing new laboratory equipment and a new caustic system and upgrading loading bay meters.

Pipeline Transportation

Our pipeline transportation operations involve the gathering and transportation of oil and natural gas for producers/shippers operating offshore in the vicinity of our pipelines in the U.S. Gulf of Mexico. Producers and shippers are charged a fee based on anticipated throughput volumes. Our pipeline transportation operations represented less than 1% of total revenue for the years ended December 31, 2013 and 2012.

Oil and Gas Exploration and Production

Our oil and gas exploration and production assets, which include leasehold interests in properties in the U.S. Gulf of Mexico and previously included a leasehold interest in Indonesia, were uneconomic for the years ended December 31, 2013 and 2012 as a result of leases being relinquished and fields being shut-in by operators. On February 28, 2013 Blue Dolphin Exploration Company, a wholly owned subsidiary (“BDEX”), completed the disposal of its 7% undivided working interest in the North Sumatra Basis – Langsa Field offshore Indonesia (“Indonesia”) pursuant to Sale and Purchase Agreement with Blue Sky Langsa Limited (“Blue Sky”) effective November 6, 2012. Our oil and gas exploration and production operations represented less than 1% of total revenue for the years ended December 31, 2013 and 2012.

Recent Developments

WBI Asset Sale Agreement. On February 25, 1999, WBI Energy Midstream, LLC, a Colorado limited liability company (“WBI”), acquired from Blue Dolphin Pipe Line Company (“BDPL”), a 1/6th, undivided beneficial interest in the Blue Dolphin Pipeline System, Galveston Area Block 350 Pipeline, and the Omega Pipeline (the “Pipeline Assets”). On March 1, 1999, WBI and BDPL, as owners of the Pipeline Assets, engaged BDPL to operate certain pipeline systems within the Pipeline Assets (the “System”) and entered into an operating agreement governing the operation of the System (the “Operating Agreement”). On February 5, 2014, WBI and BDPL entered into an Asset Sale Agreement (the “Purchase Agreement”), whereby BDPL reacquired WBI’s 1/6 interest in the Pipeline Assets, effective October 31, 2013.

Pursuant to the Purchase Agreement, WBI paid BDPL \$100,000 in cash and \$850,000 in the form of a bond in exchange for the payment and discharge of any and all payables, claims, and obligations related to the Pipeline Assets. Effective October 31, 2013, WBI and BDPL mutually agreed to terminate the Operating Agreement whereby BDPL is now the sole owner and operator of the Pipeline Assets therein.

Master Easement Agreement - BDPL and FLNG Land. On December 11, 2013 (the “Effective Date”), BDPL and FLNG Land, II, Inc., a Delaware corporation (“FLNG”), entered into a Master Easement Agreement (the “Master Easement Agreement”) whereby BDPL is providing FLNG with: (i) free and uninterrupted pedestrian and vehicular ingress and egress to and from State Highway 332, across the certain property of BDPL to certain property of FLNG (the “Access Easement”) and (ii) a perpetual permanent pipeline easement and right of way across certain property of BDPL to certain property owned by FLNG (the “Pipeline Easement” and together with the Access Easement, the “Easements”). As initial consideration for the grant of the Easements, FLNG paid BDPL the sum of \$250,000 (the “Initial Payment”) on the Effective Date. FLNG has the option to terminate the Master Easement Agreement within ten (10) months of the Effective Date. If FLNG commences improvements within the Access Easement or commences construction within the Pipeline Easement (the “Commencement Date”), FLNG shall make a second payment of \$250,000 to BDPL (the “Second Payment”).

If FLNG elects to make the Second Payment, then on or before the first anniversary of the Commencement Date through the greater of: (i) the fifth anniversary of said date or (ii) the date on which the third of FLNG’s planned liquefaction pre-treatment train facilities has reached completion sufficient to permit its start-up and initial operational

testing, FLNG shall make annual payments of \$500,000 (“the Annual Payments”) to BDPL. Upon delivery of the Initial Payment, Second Payment, and each of the remaining Annual Payments, the Easements shall be fully paid for by FLNG. On the anniversary of the date when the final Annual Payment is made, FLNG will pay to BDPL the sum of \$10,000 annually for so long as FLNG desires to use the Access Easement. The terms of the Easements are perpetual, unless terminated by FLNG prior to the Commencement Date or if FLNG elects to permanently cease use of the Access Easement or Pipeline Easement, as applicable.

Ongoing Acquisition and Disposition Activities

Consistent with our growth strategy, we are continuously engaged in discussions with potential sellers of assets, including Lazarus Energy Holdings, LLC (“LEH”), our majority stockholder, regarding the possible purchase of assets and operations that are strategic and complementary to our existing operations. These acquisition efforts may involve participation by us in processes that have been made public and involve a number of potential buyers, commonly referred to as “auction” processes, as well as situations in which we believe we are the only potential buyer or one of a limited number of potential buyers in negotiations with the potential seller. These acquisition efforts often involve assets and operations which, if acquired, could have a material effect on our financial condition and results of operations and require special financing.

The closing of any transaction for which we have entered into a definitive acquisition agreement will be subject to customary and other closing conditions, which may not ultimately be satisfied or waived. Accordingly, we can give no assurance that our current or future acquisition efforts will be successful. Although we expect the acquisitions we make to be accretive in the long-term, we can provide no assurance that our expectations will ultimately be realized.

Intellectual Property

We rely on intellectual property laws to protect our brand, as well as those of our subsidiaries. “Blue Dolphin” is a registered trademark in the U.S. in name and logo form. “Petroport” is a registered trademark in the U.S. in name form. In addition, www.blue-dolphin.com and www.blue-dolphin-energy.com are registered domain names.

Employees

In connection with Blue Dolphin’s acquisition of LE in February 2012 (the “LE Acquisition”), we entered into a Management Agreement with LEH (the “Management Agreement”) pursuant to which LEH manages all of our subsidiaries and operates all of our assets, including the Nixon Facility. Under the Management Agreement, all Blue Dolphin personnel work for and are paid directly by LEH. LEH bills Blue Dolphin at cost for certain personnel associated with BDPL.

Governmental Regulation

All of our operations and properties are subject to extensive and complex federal, state, and local environmental, health, and safety statutes, regulations, and ordinances governing, among other things, the generation, storage, handling, use and transportation of petroleum, solid wastes, hazardous wastes, and hazardous substances; the emission and discharge of materials into the environment and environmental protection; waste management; characteristics and composition of diesel and other fuels; and the monitoring, reporting and control of greenhouse gas emissions. These laws impose certain obligations on our operations, including requiring the acquisition of permits and authorizations to conduct regulated activities, restricting the manner in which regulated activities are conducted, limiting the quantities and types of materials that may be released into the environment, and requiring the monitoring of releases of materials into the environment.

Failure to comply with environmental, health or safety laws and our permits or other authorizations issued under such laws could result in fines, civil or criminal penalties or other sanctions, injunctive relief compelling the installation of additional controls, or a revocation of our permits and the shutdown of our facilities.

We cannot predict the extent to which additional environmental, health, and safety laws will be enacted in the future, or how existing or future laws will be interpreted with respect to our operations. Many environmental, health, and safety laws and regulations are becoming increasingly stringent. The cost of compliance with and governmental enforcement of environmental, health, and safety laws may increase in the future. We may be required to make significant capital expenditures or incur increased operating costs to achieve compliance with applicable environmental, health, and safety laws. This Governmental Regulation section should be read in conjunction with the "Forward-Looking Statements" and Part I, Item 1A “Risk Factors” sections in this Form 10-K , which discuss our expectations regarding future events, results or outcomes based on currently available information.

The Energy Policy Act of 2005 and the Energy Independence and Security Act of 2007 (the “Energy Acts of 2005 and 2007”). Pursuant to the Energy Acts of 2005 and 2007, the Environmental Protection Agency (the “EPA”) issued Renewable Fuels Standards (“RFS”) that mandate the blending of renewable fuels into refined petroleum fuel products. Although the Nixon Facility is currently subject to this requirement, we have applied for a hardship exemption based on the Nixon Facility’s small refiner status. The EPA establishes new volume requirements and associated percentage

standards on an annual basis that subject refineries to RFS. The volume requirements and associated percentage standards increase through 2022, when all facilities will be subject to the requirements.

The Federal Clean Air Act (the “CAA”). The CAA, its amendments and implementing regulations, as well as the corresponding state laws and regulations that regulate emissions of pollutants into the air, affect our crude oil and condensate processing operations and impact certain emissions sources located offshore. Under the CAA, facilities that emit volatile organic compounds or nitrogen oxides face increasingly stringent regulations. The EPA has, in the past, targeted petroleum refineries as part of a nationwide enforcement initiative, and refineries remain high-visibility targets for enforcement under the CAA. In 1992, the EPA published a list of source categories (industry groups) that emit one or more of a list of 188 hazardous air pollutants (“HAPs”), also known as air toxics. The list of industry groups includes petroleum refineries because they are considered to be a major source of HAP emissions. The EPA developed standards that require the application of maximum achievable control technology (“MACT”) to help control HAP emissions. The Petroleum Refinery MACT standard applies to petroleum refining process units and related emission points. We are required to obtain permits, as well as to test, monitor, report and implement control requirements. In addition, our operations are subject to a number of New Source Performance Standards (“NSPS”) regulations. For example, in September 2012, the EPA issued final revisions to the NSPS for process heaters and flares at petroleum refineries. The final NSPS regulate emissions of nitrogen oxide from process heaters and emissions of sulfur dioxide from flares. The final rule also establishes work practice and monitoring standards for flares. In addition, air permits incorporating stringent control technology requirements are required for our refining operations that result in the emission of regulated air contaminants.

The CAA also authorizes the EPA to require modifications in the formulation of refined fuel products. In 2007, the EPA issued a second Mobile Source Air Toxics standard (the “MSAT II”) that required significant reductions in the sulfur content in gasoline and diesel fuel. These standards required most refineries to reduce the sulfur content in diesel to 15 parts per million (“ppm”) and gasoline to 30 ppm. Low sulfur (500 ppm) and ULSD fuel is expected to be phased in for diesel engines in June 2014. When implemented for diesel, the MSAT II requirements may require us to undergo additional permitting and/or incur capital expenditures to meet the new requirements. We can continue to sell low sulfur distillates to other refineries and blenders as a feedstock in the United States and as a finished petroleum product to other countries after the new standards are implemented. We do not currently manufacture gasoline.

In 2007 the U.S. Supreme Court held in *Massachusetts v. EPA* that greenhouse gas emissions may be regulated as an air pollutant under the CAA. In December 2009, the EPA published a finding that greenhouse gas emissions present an endangerment to human health and the environment because emissions of such gasses are contributing to changes in climate. The EPA has since issued regulations that require a reduction in emissions of greenhouse gases from motor vehicles and that require greenhouse gas emission permits for certain sources. Specifically, the EPA has adopted regulations under existing provisions of the CAA establishing Prevention of Significant Deterioration (“PSD”) construction and Title V operation permits requiring reviews for greenhouse gasses for certain large, stationary sources. In September 2009, the EPA issued a final rule requiring the reporting of greenhouse gas emissions from specified large greenhouse gas emission sources, including refineries. In addition, pursuant to a December 23, 2010 settlement agreement EPA was required to propose by December 10, 2011, NSPS for greenhouse gas emissions for refineries and to finalize such rules by November 15, 2012. To date, however, the EPA has not initiated that rulemaking. The adoption of future legislation limiting greenhouse gas emissions could cause us to incur additional compliance costs and may affect the demand for our products.

Occupational Safety and Health Administration (“OSHA”). In 2007, OSHA launched the National Emphasis Program for Petroleum Refineries (“RNEP”). The RNEP requires inspections of all refineries for compliance with process safety management regulations. Under the directive, our crude oil and condensate processing assets are subject to inspections that may last from two to six months, including one to three months on-site. Inspectors focus on checking process safety management implementation and records targeting specific process units and strategically sampling equipment, records and personnel. All of our operations are subject to OSHA’s standards for safe and healthful working conditions for personnel.

The Federal Water Pollution Control Act, also known as the Clean Water Act (the “CWA”). The CWA and its implementing regulations, as well as the corresponding state laws and regulations that regulate the discharge of pollutants, including spills and leaks of oil and other substances, into the water. The CWA and analogous state laws affect our crude oil and condensate processing operations, petroleum storage and terminaling operations, pipeline operations and exploration and production activities. The CWA prohibits the discharge of pollutants to waters of the United States except as authorized by the terms of a permit issued by the EPA or a state agency with delegated authority. Spill prevention, control, and countermeasure (“SPCC”) requirements mandate the use of structures, such as berms and other secondary containment, to prevent hydrocarbons or other pollutants from reaching a jurisdictional water in the event of a spill or leak. Federal and state regulatory agencies can impose administrative, civil, and criminal penalties for non-compliance with discharge permits or other requirements of the CWA or analogous state laws and regulations.

The Oil Pollution Act of 1990 (the “OPA”). The OPA and regulations promulgated thereunder include a variety of requirements related to the prevention of oil spills and impose liability for damages resulting from such spills. OPA imposes liability on owners and operators of onshore and offshore facilities and pipelines for removal costs and certain public and private damages arising from a spill. OPA establishes a liability limit for onshore facilities of \$350 million and offshore facilities of \$75 million plus all clean-up costs. OPA establishes lesser liability limits for vessels depending upon their size. A party cannot take advantage of the liability limits if the spill is caused by gross

negligence or willful misconduct or resulted from a violation of federal safety, construction or operating regulations. If a party fails to report a spill or cooperate in the clean-up, liability limits do not apply. OPA imposes ongoing requirements on responsible parties, including proof of financial responsibility for potential spills. In October 1996, the U.S. Congress enacted the Coast Guard Authorization Act of 1996 (P.L. 104-324), which amended OPA to establish requirements for evidence of financial responsibility for certain offshore facilities. The evidence of financial responsibility amount required is \$35 million for certain types of offshore facilities located seaward of the seaward boundary of a state, including properties used for oil transportation. We currently maintain the statutory \$35 million coverage. While our financial responsibility requirements under OPA may be amended to impose additional costs, we do not expect the impact of such a change to be any more burdensome on us than on others similarly situated.

Outer Continental Shelf Lands Act (the “OCSLA”). Our pipeline operations and exploration and production activities within federal waters are subject to the requirements of OCSLA, which is administered by the Bureau of Ocean Energy Management (the “BOEM”) and the Bureau of Safety and Environmental Enforcement (the “BSEE”). BOEM oversees offshore leasing, resource evaluation, review and administration of oil and gas exploration and development plans, renewable energy development, National Environmental Policy Act analysis and environmental studies. BSEE is responsible for safety and environmental oversight of offshore oil and gas operations, including the development and enforcement of safety and environmental regulations, permitting of offshore exploration, development and production, inspections, offshore regulatory programs and oil spill response compliance.

The Comprehensive Environmental Response, Compensation and Liability Act (“CERCLA”). CERCLA imposes liability, without regard to fault or the legality of the original conduct, on parties the statute defines as responsible for the release or threatened release of a “hazardous substance” into the environment. Responsible parties, which include the present owner or operator of a site where the release occurred, the owner or operator of the site at the time of disposal of the hazardous substance and persons that disposed of or arranged for the disposal of a hazardous substance, are liable for response and remediation costs and for damages to natural resources. Petroleum and natural gas are excluded from the definition of hazardous substances; however, this exclusion does not apply to all materials used in our operations. State statutes impose similar liability. At this time, neither we nor any of our predecessors have been designated as a potentially responsible party under CERCLA or similar state statute.

The Federal Resource Conservation and Recovery Act (“RCRA”). RCRA and its state counterparts regulate solid and hazardous wastes and impose civil and criminal penalties for improper handling and disposal of such wastes. EPA and various state agencies have promulgated regulations that limit the disposal options for such wastes. Certain wastes generated by our oil and gas operations are currently exempt from regulation as hazardous wastes, but are subject to non-hazardous waste regulations. In the future these wastes could be designated as hazardous wastes under RCRA or other applicable statutes and therefore may become subject to more rigorous and costly requirements.

We currently own or lease, or have in the past owned or leased, various properties used for the crude oil and processing assets, petroleum storage and terminaling assets, pipeline assets and oil and gas leasehold interests used to process and store solid and hazardous wastes. Although our past operating and disposal practices at these properties were standard for the industry at the time, hydrocarbons or other substances may have been disposed of or released on or under these properties or on or under other locations. In addition, many of these properties have been operated by third parties whose waste handling activities were not under our control. These properties and any waste disposed thereon may be subject to CERCLA, RCRA, and state laws which could require us to remove or remediate wastes and other contamination or to perform remedial plugging operations to prevent future contamination.

Environmental

See “Part II, Item 8. Financial Statements and Supplementary Data – Note (26) Commitments and Contingencies” of this report for a description of our environmental activities.

Available Information

The SEC maintains and makes available public records, which includes reports filed by regulated companies and individuals, through conventional and electronic reading rooms. The SEC’s conventional reading room is located at 100 F Street, Northeast, Washington, D.C. 20549 and can be reached at (202) 551-8300. The SEC’s electronic reading room, which maintains records created by the SEC on or after November 1, 1996, is available online at <http://www.sec.gov/foia/efoiapg.htm>. Reports filed with the SEC by regulated entities and individuals are available at <http://www.sec.gov/edgar/searchedgar/webusers.htm>. We also make our public filings available on our website (<http://www.blue-dolphin-energy.com>) as soon as reasonably practicable after such material is filed, or furnished, to

the SEC. A copy of our filings will also be furnished free of charge upon request.

Information about each of our directors, our Audit Committee Charter and our code of conduct and code of ethics are available on our website. Information contained on our website is not part of this report.

Glossary of Industry Terms

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

Atmospheric Gas Oil. The heaviest product boiled by a crude distillation unit operating at atmospheric pressure. This fraction ordinarily sells as distillate fuel oil, either in pure form or blended with cracked stocks. In-blends atmospheric gas oil, often abbreviated AGO, usually serves as the premium quality component used to lift lesser streams to the standards of saleable furnace oil or diesel engine fuel. Certain ethylene plants, called heavy oil crackers, can take AGO as feedstock.

Bbl. One stock tank barrel, or 42 U.S. gallons of liquid volume, used in reference to oil or other liquid hydrocarbons.

Blending. The physical mixture of a number of different liquid hydrocarbons to produce a finished product with certain desired characteristics. Products can be blended in-line through a manifold system, or batch blended in tanks and vessels. In-line blending of gasoline, distillates, jet fuel and kerosene is accomplished by injecting proportionate amounts of each component into the main stream where turbulence promotes thorough mixing. Additives, including octane enhancers, metal deactivators, anti-oxidants, anti-knock agents, gum and rust inhibitors, and detergents, are added during and/or after blending to result in specifically desired properties not inherent in hydrocarbons.

Bpd. Barrels per day.

Condensate. Liquid hydrocarbons that are produced in conjunction with natural gas. Condensate is chemically more complex than liquefied petroleum gas. Although condensate is sometimes similar to crude oil or naphtha, it is usually lighter.

Cooling Tower. A structure that cools heated refining process water by circulating the water through a series of louvers and baffles through which cool air is forced by large fans.

Crude Oil. A mixture of thousands of chemicals and compounds, primarily hydrocarbons. Crude oil must be broken down into its various components by distillation before these chemicals and compounds can be used as fuels or converted to more valuable products. There are primarily five types of crude – West Texas Intermediate (“WTI”), Light Crude, Sweet Crude, Sour Crude and Brent Crude. See definitions of WTI, Light Crude, Sweet Crude and Sour Crude.

Crude Unit. The refinery processing unit where initial crude oil distillation takes place. See definition of Topping Unit.

Cut. One or more crude oil compounds that vaporize and are extracted within a certain temperature range during the crude distillation process.

Depropanizer. A distillation column that is used to isolate propane from a mixture containing butane and other heavy components.

Desalting. Removal of salt from crude oil. Desalting is preferably performed prior to commercialization of the crude; must be performed prior to refining.

Distillates. The result of crude distillation and therefore any refined oil product. Distillate is more commonly used as an abbreviated form of middle distillate. There are mainly four (4) types of distillates: (i) very light oils or light distillates (e.g., jet fuel, gasoline, kerosene, and naphtha), (ii) light oils or middle distillates, (iii) medium oils, and (iv) heavy fuel oils.

Distillation. The first step in the refining process whereby crude oil is heated in the base of a distillation tower. As the temperature increases, the crude's various compounds vaporize in succession at their various boiling points and then rise to prescribed levels within the tower according to their densities, from lightest to heaviest. They then condense in distillation trays and are drawn off individually for further refining. Distillation is also used at other points in the refining process to remove impurities.

Distillation Tower. A tall column-like vessel in which crude oil is heated and its vaporized components distilled by means of distillation trays.

Exchanger (Heat Exchanger). A device used to transfer heat from one process liquid to another.

Feedstocks. Processed oil destined for further processing other than blending. It is transformed into one or more components and/or finished products.

Fractionation. The separation of crude oil into its more valuable and usable components through distillation.

Field. An area consisting of a single reservoir or multiple reservoirs all grouped on or related to the same individual geological structural feature and/or stratigraphic condition.

Finished Petroleum Products. Materials or products which have received the final increments of value through processing operations, and which are being held in inventory for delivery, sale, or use.

Heat Exchanger. See definition for Exchanger.

Intermediate Petroleum Products. A product that might require further processing before it is saleable to the ultimate consumer. This further processing might be done by the producer or by another processor. Thus, an intermediate product might be a final product for one company and an input for another company that will process it further.

Jet Fuel. A high-quality kerosene product primarily used in aviation. Kerosene-type jet fuel (including Jet A and Jet A-1) has a carbon number distribution between about 8 and 16 carbon atoms per molecule; wide-cut or naphtha-type jet fuel (including Jet B) has between about 5 and 15 carbon atoms per molecule. Jet fuel is a white product, so-called because it is transparent.

Kerosene. A middle distillate fraction of crude oil that is produced at higher temperatures than naphtha and lower temperatures than gas oil. It is usually used as jet turbine fuel and sometimes for domestic cooking, heating and lighting.

Leasehold Interest. The interest of a lessee under an oil and gas lease.

Light Crude. Crude oil with a low wax content.

Liquefied Petroleum Gas (“LPG”). Manufactured during the refining of crude oil. LPG burns relatively cleanly with no soot and very few sulfur emissions.

MMcf. One million cubic feet of gas.

Naphtha. A refined or partly refined light distillate fraction of crude oil. Blended further or mixed with other materials it makes high-grade motor gasoline or jet fuel. It is also a generic term applied to the lightest and most volatile petroleum fractions.

Net Revenue Interest. The percentage of production to which the owner of a working interest is entitled.

Non-Road, Locomotive and Marine Diesel Fuel (“NRLM”). Commonly referred to as “off-road diesel.” Used in diesel engines for construction, agricultural, stationary engine, locomotive and marine operations. Typically, off-road diesel has a higher sulfur content than on-road diesel.

Overriding Royalty Interest. An interest in oil and gas produced at the surface, free of the expense of production that is in addition to the usual royalty interest reserved to the lessor in an oil and gas lease.

Petroleum. A naturally occurring flammable liquid consisting of a complex mixture of hydrocarbons of various molecular weights and other liquid organic compounds. The name petroleum covers both the naturally occurring unprocessed crude oils and petroleum products that are made up of refined crude oil.

Ppm. Parts per million.

Propane. A by-product of natural gas processing and petroleum refining. Propane is one of a group of liquefied petroleum gases. The others include butane, propylene, butadiene, butylene, isobutylene and mixtures thereof. See definition of Liquefied Petroleum Gas.

Recommissioning. While commissioning of a new plant facility or refinery helps ensure correct operation of its major systems when first installed, recommissioning helps to restore an existing plant facility or refinery to its originally

intended operating performance. Both processes comprise the integrated application of a set of engineering techniques and procedures to check, inspect and test every operational component of the project, from individual functions such as instruments and equipment, up to complex amalgamations, such as modules, subsystems and systems.

Refined Petroleum Products. Refined petroleum products are derived from crude oils that have been processed through various refining methods. The resulting products include gasoline, home heating oil, jet fuel, diesel, lubricants and the raw materials for fertilizer, chemicals and pharmaceuticals. Following the refining process, the products are transported to terminals or local distribution centers for sale to various end-users and consumers.

Refinery. A plant where crude oil is separated and transformed into marketable refined petroleum products.

Separation. The separation of the different hydrocarbons present in crude oil depending on their respective boiling ranges. This process takes place in a distillation column.

Sour Crude. Crude oil containing sulfur content of more than 0.5%. Usually processed into heavy oil such as diesel.

Stabilizer. A distillation column intended to remove the lighter boiling compounds, such as butane or propane from a product.

Sweet Crude. Crude oil containing sulfur content of less than 0.5%. Commonly used for processing into gasoline.

Sulfur. Present at various levels of concentration in many hydrocarbon deposits, such as petroleum, coal or natural gas. Also produced as a byproduct of removing sulfur-containing contaminants from natural gas and petroleum. Some of the most commonly used hydrocarbon deposits are categorized according to their sulfur content, with lower sulfur fuels usually selling at a higher, premium price and higher sulfur fuels selling at a lower, or discounted, price.

Topping Unit (Atmospheric Distillation). Conducts the initial transformation of crude oil at a refinery. The topping unit heats crude oil at atmospheric pressure to accomplish the first rough distillation cut. Lighter products produced in this process can be further refined in a catalytic cracking unit or reforming unit. Heavier products, which cannot be vaporized and separated in this process, can be further distilled in a vacuum distillation unit or coker.

Turnaround. Scheduled large-scale maintenance activity wherein an entire process unit is taken offline for a week or more for comprehensive revamp and renewal.

Ultra-low-sulfur Diesel (“ULSD”)(On-Road Diesel). Diesel fuel with substantially lowered sulfur content (currently 15 ppm). Primarily used as commercial transportation fuel.

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 and in which the interests of the parties are not specified whether by percentage or portion of the property.

West Texas Intermediate (“WTI”). A grade of crude oil used as a benchmark in oil pricing. Described as intermediate because of its relative mid-range density and mid-range sulfur content.

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 after the corresponding percentage of operational costs and royalties are paid.

ITEM 1A. RISK FACTORS

There are numerous factors that affect our business and operating results, many of which are beyond our control. The following is a description of significant factors that might cause our future operating results to differ materially from those currently expected. The risks described below are not the only risks we face. Additional risks and uncertainties not specified herein, not currently known to us or currently deemed to be immaterial also may materially adversely affect our business, financial condition, operating results and/or cash flows.

Risks Related to our Business

The price volatility of crude oil, other feedstocks, refined products and fuel and utility services may have a material adverse effect on our earnings, cash flows and liquidity.

Our refining earnings, cash flows and liquidity from operations depend primarily on the margin above operating expenses (including the cost of refinery feedstocks, such as crude oil and natural gas liquids that are processed and

blended into refined products) at which we are able to sell refined products. Refining is primarily a margin-based business. To increase earnings it is important to maximize and optimize the yields of finished products while minimizing the costs of feedstock and operating expenses. When the margin between refined product prices and crude oil and other feedstock costs contracts, our earnings and cash flows are negatively affected. Refining margins historically have been volatile, and are likely to continue to be volatile, as a result of a variety of factors, including fluctuations in the prices of crude oil, other feedstocks, refined products and fuel and utility services. While an increase or decrease in the price of crude oil may result in a similar increase or decrease in prices for refined products, there may be a time lag in the realization of the similar increase or decrease in prices for refined products. The effect of changes in crude oil prices on our refining margins therefore depends in part on how quickly and how fully refined product prices adjust to reflect these changes.

Prices of crude oil, other feedstocks and refined products depend on numerous factors beyond our control, including the supply of and demand for crude oil, other feedstocks, diesel, and other refined products. Such supply and demand are affected by, among other things:

- changes in global and local economic conditions;
- domestic and foreign demand for fuel products, especially in the United States, China and India;
- worldwide political conditions, particularly in significant oil producing regions such as the Middle East, West Africa and Latin America;
- the level of foreign and domestic production of crude oil and refined products and the volume of crude oil, feedstock and refined products imported into the United States;
- availability of and access to transportation infrastructure;
- utilization rates of U.S. refineries;
- the ability of the members of the Organization of Petroleum Exporting Countries to affect oil prices and maintain production controls;
- development and marketing of alternative and competing fuels;
- commodities speculation;
- natural disasters (such as hurricanes and tornadoes), accidents, interruptions in transportation, inclement weather or other events that can cause unscheduled shutdowns or otherwise adversely affect our refineries;
- federal and state government regulations and taxes; and
- local factors, including market conditions, weather conditions and the level of operations of other refineries and pipelines in our markets.

Refining margins are volatile, and a reduction in anticipated refining margins will adversely affect the amount of cash we will have available for working capital.

Historically, refining margins have been volatile, and they are likely to continue to be volatile in the future. Our financial results are primarily affected by the relationship, or margin, between our refined petroleum products prices and the prices for crude oil. The cost to acquire crude oil and the price at which we can ultimately sell our refined petroleum products depend upon numerous factors beyond our control.

The prices at which we sell refined petroleum products are strongly influenced by the commodity price of crude oil. If crude oil prices increase, our refined petroleum products segment margins will fall unless we are able to pass along these price increases to our wholesale customers. Increases in selling prices for refined petroleum products typically lag behind the rising cost of crude oil and may be difficult to implement when crude oil costs increase dramatically over a short period of time.

Our operations are highly dependent on our relationship with Genesis and LEH, and, if we are unable to successfully maintain these relationships, our operations, liquidity and financial condition may be harmed.

We are party to a variety of contracts and agreements with Genesis and its affiliates that enable the purchase of crude oil, transportation of crude oil, provision of accounting and other services, joint marketing of our refined petroleum products and funding of renovations, expansion and other capital expenditures relating to the Nixon Facility. Certain of these agreements with Genesis and its affiliates have an initial term of three years and successive one-year renewals until August 12, 2019 unless sooner terminated by Genesis or its affiliates with 180 days prior written notice. Further, we have an understanding with Genesis relating to an inventory risk management system, which is intended to reduce the commodity price risk of our finished products inventory and generate a more consistent gross margin for each barrel of refined product.

LEH manages all of our subsidiaries and operates all of our assets, including the Nixon Facility, pursuant to the Management Agreement. The Management Agreement expires on the earliest to occur of: (a) the termination date of a certain agreement with a Genesis affiliate, which has an initial term of three years and successive one-year renewals until August 12, 2019 unless sooner terminated by the Genesis affiliate with 180 days prior written notice, (b) August 12, 2014, or (c) upon written notice of either party to the Management Agreement of a material breach of the Management Agreement by the other party.

These agreements and understandings require us to have a close working relationship with Genesis and LEH in order for us to be successful in fully executing our business strategy. If we are unable to maintain these relationships or our relationships are not on good terms, it could have a material adverse effect on our operations, liquidity and financial condition.

Genesis and LEH may, but are not required to, fund our working capital requirements.

Historically, we have used a portion of our cash reserves and revenue from operations to fund our working capital requirements. To the extent that we are unable to fund our working capital requirements from cash reserves and revenue from operations, we have relied on Genesis and LEH for our working capital requirements. As of December 31, 2013, working capital requirements financed by Genesis and LEH was \$2,538,077 and \$3,659,340, respectively. In the event our working capital requirements are not funded by Genesis or LEH, or we are otherwise unable to secure sufficient liquidity to support our short term and/or long-term capital requirements, we may not be able to meet our payment obligations, comply with certain deadlines related to environmental regulations and standards or pursue our business strategies, any of which may have a material adverse effect on our results of operations or liquidity.

We may have capital needs for which our internally generated cash flows and other sources of liquidity may not be adequate.

Historically, we have used a portion of our cash reserves to fund our working capital requirements that were not funded from our operations. Most recently, we have relied on advances under the Construction Funding Agreement and revenue from operations, including sales of refined products and rental of storage tanks, to fund our working capital requirements. Currently we expect that these resources will be sufficient to satisfy our anticipated working capital requirements over the next 12 – 18 months. If we cannot generate sufficient cash flows from operations, continue to make advances under the Construction and Funding Agreement or otherwise secure sufficient liquidity to support our short-term and long-term capital requirements, we may not be able to meet our payment obligations, comply with certain deadlines related to environmental regulations and standards or pursue our business strategies, any of which could have a material adverse effect on our results of operations or liquidity. Our short-term working capital needs are primarily related to repayment of a loan agreement (the “Loan Agreement”) dated September 29, 2008 by and between LE and First International Bank as evidenced by that certain promissory note, of even date with the Loan Agreement, in the original principal amount of \$10,000,000. Our long-term needs for cash include those to support ongoing capital expenditures for equipment maintenance and upgrades at the Nixon Facility. In addition, from time to time, we expect to utilize significant capital to upgrade equipment, improve facilities and reduce operational, safety and environmental risks. We may incur substantial compliance costs in connection with any new environmental, health and safety regulations. Our liquidity will affect our ability to satisfy any of these needs.

As of December 31, 2013, we were in default of certain financial covenants related to a loan agreement. Although our lender granted a temporary waiver effective December 31, 2013 through December 31, 2014, our failure to comply with certain financial covenants in the loan agreement could materially and adversely affect our operating results and our financial condition.

We cannot assure that our assets or cash flow would be sufficient to fully repay borrowings under our outstanding notes payable, either upon maturity or if accelerated, or that we would be able to refinance or restructure the payments on the notes payable. If we fail to comply with covenants associated with the long-term debt and such failure is not cured or waived, then the senior lender may exercise any rights and remedies available under the loan agreement and applicable law including, without limitation, foreclosing on our assets. Any such action by our senior secured lender would have a material adverse effect on our financial condition and ability to continue as a going concern.

In June 2014, new environmental regulations become effective that reduce the allowable sulfur content for commercially sold diesel in the United States. Unless the Nixon Facility undergoes significant capital upgrades, we may be limited to selling our diesel as a distillate feedstock at lower prices.

New environmental regulations will become effective in June 2014 that reduce the sulfur content that is permitted to be contained in commercially sold diesel in the United States. In order to meet the lower sulfur content requirement for NRLM in the United States, the Nixon Facility may require capital upgrades in excess of approximately \$50 million. In order to complete the required capital upgrades, we will have to finance such capital expenditures primarily through the issuance of debt and/or equity, which would result in dilution to existing stockholders and/or subject us to higher debt levels. We can continue to sell diesel with a higher sulfur content in the United States to other refineries and blenders as a feedstock and to other countries as a finished petroleum product. There can be no assurance that we can: (i) obtain financing for capital expenditures at rates or at terms acceptable to us, if at all, (ii) sell diesel with a higher sulfur content in the United States to other refineries and blenders as feedstock or overseas as a finished product, or (iii) sell higher sulfur diesel content at prices that we deem reasonable or at all.

If sufficient RINs are unavailable for purchase or if we have to pay a significantly higher price for RINs, or if we are otherwise unable to meet the EPA's RFS mandates, our business, financial condition and results of operations could be

materially adversely affected.

Pursuant to the Energy Independence and Security Act of 2007, the EPA has promulgated the Renewable Fuel Standard, or RFS, which requires refiners to blend "renewable fuels," such as ethanol, with their petroleum fuels or purchase renewable energy credits, known as RINs, in lieu of blending. Under the RFS, the volume of renewable fuels refineries like us are obligated to blend into their finished petroleum products increases annually over time until 2022. Beginning in February 2012, the Nixon Facility was required to blend renewable fuels into its diesel fuel or purchase RINs in lieu of blending. We submitted and lodged an application with the EPA requesting a small refinery exemption under the RFS mandate ("Hardship Exemption") due to disproportionate economic hardship and disparate impact that compliance with the RFS mandate would have on the Nixon Facility. There is no guarantee that the EPA will grant us the Hardship Exemption. In addition, existing laws and/or regulations could change, and the minimum volumes of renewable fuels that must be blended with refined petroleum products may increase. If we are not granted the Hardship Exemption, we may be required to purchase additional RINs on the open market and waiver credits from the EPA in order to comply with the RFS. Recently the price of RINs has been extremely volatile with pricing increases. We cannot predict the future prices of RINs or waiver credits, but the costs to obtain the necessary number of RINs and waiver credits could likely be material. Additionally, because we do not produce renewable fuels, increasing the volume of renewable fuels that must be blended into our products displaces an increasing volume of our refineries' product pool, potentially materially affecting our business, financial condition, results of operations, and cash flows.

We are subject to strict laws and regulations regarding employee and process safety, and failure to comply with these laws and regulations could have a material adverse effect on our results of operations, financial condition and profitability.

We are subject to the requirements of OSHA and comparable state statutes that regulate the protection of the health and safety of workers, and the proper design, operation and maintenance of our equipment. In addition, OSHA and certain environmental regulations require that we maintain information about hazardous materials used or produced in our operations and that we provide this information to employees and state and local governmental authorities. Failure to comply with these requirements, including general industry standards, record keeping requirements and monitoring and control of occupational exposure to regulated substances, may result in significant fines or compliance costs, which could have a material adverse effect on our results of operations, financial condition and cash flows.

We may incur significant liability as a result of, or costs and capital expenditures to comply with, health, safety and environmental regulations relating to the recommissioning of the Nixon Facility and/or as a result of new or modified laws and regulations.

The Nixon Facility returned to service in February 2012. We are currently undergoing a comprehensive review to determine our compliance with relevant federal, state and local environmental laws. During the course of our review, we may discover that we are not in compliance with existing environmental regulations. To the extent that we are out of compliance, we may incur significant liabilities, costs and capital expenditures to comply with such environmental regulations, which are complex and change frequently. Costs of compliance are often unpredictable, and there can be no assurance that the future costs will not be material. It is possible that we may identify additional cost in the future, which could result in additional obligations and expenses, including fines and penalties.

Our refinery, pipelines and other operations are subject to federal, state and local laws regulating, among other things, the generation, storage, handling, use and transportation of petroleum and hazardous substances, the emission and discharge of materials into the environment, waste management, characteristics and composition of diesel and other matters otherwise relating to the protection of the environment. Our operations are also subject to various laws and regulations relating to occupational health and safety. Compliance with the complex array of federal, state and local laws relating to the protection of the environment, health and safety is difficult and likely will require us to make significant expenditures. Moreover, our business is inherently subject to accidental spills, discharges or other releases of petroleum or hazardous substances into the environment including at neighboring areas or third-party storage, treatment or disposal facilities. Certain environmental laws impose joint and several liability without regard to fault or the legality of the original conduct in connection with the investigation and cleanup of such spills, discharges or releases. As such, we may be required to pay more than our fair share of such investigation or cleanup. We may not be able to operate in compliance with all applicable environmental, health and safety laws, regulations and permits at all times. Violations of applicable legal or regulatory requirements could result in substantial fines, criminal sanctions, permit revocations, injunctions and/or facility shutdowns. We may also be required to make significant capital expenditures or incur increased operating costs or change operations to achieve compliance with applicable standards.

We cannot predict the extent to which additional environmental, health and safety legislation or regulations will be enacted or become effective in the future or how existing or future laws or regulations will be administered or interpreted with respect to our operations. Many of these laws and regulations are becoming increasingly stringent, and the cost of compliance with these requirements can be expected to increase over time. For example, on September 12, 2012, the EPA published final amendments to the New Source Performance Standards (“NSPS”) for petroleum refineries to be effective November 13, 2012. These amendments include standards for emissions of nitrogen oxides from process heaters and work practice standards and monitoring requirements for flares. We continue to evaluate the regulation and amended standards, as may be applicable to the operations at our refinery. We cannot currently predict costs we may incur, if any, to comply with the amended NSPS, but the costs could be material. Expenditures or costs for environmental, health and safety compliance could have a material adverse effect on our results of operations, financial condition and profitability and, as a result, our ability to make distributions.

Regulation of greenhouse gas emissions could increase our operational costs and reduce demand for our products.

Continued political attention to issues concerning climate change, the role of human activity in it, and potential mitigation through regulation could have a material impact on our operations and financial results.

International agreements and national or regional legislation and regulatory measures to limit greenhouse emissions are currently in various stages of discussion or implementation. These and other greenhouse gas emissions-related laws, policies and regulations may result in substantial capital, compliance, operating and maintenance costs. The level of expenditure required to comply with these laws and regulations is uncertain and is expected to vary depending on the laws enacted in each jurisdiction, our activities in the particular jurisdiction and market conditions. Greenhouse gas emissions that could be regulated include those arising from the conversion of crude oil into refined petroleum products, the transportation of crude oil and natural gas, and the exploration and production of crude oil and natural gas. Some matters related to these activities, such as actions taken by our competitors in response to such laws and regulations, are beyond our control.

The effect of regulation on our financial performance will depend on a number of factors including, among others, the sectors covered, the greenhouse gas emissions reductions required by law, the extent to which we would be entitled to receive emission allowance allocations or would need to purchase compliance instruments on the open market or through auctions, the price and availability of emission allowances and credits and the impact of legislation or other regulation on our ability to recover the costs incurred through the pricing of our products. Material price increases or incentives to conserve or use alternative energy sources could also reduce demand for products we currently sell and

adversely affect our sales volumes, revenues and margins.

Our primary source of crude oil supply experiences significant price swings, which impacts our crude oil acquisition cost.

The Nixon Facility is located in the heart of the Eagle Ford Shale play, an abundant source of domestic petroleum production. The gathering infrastructure in this area is developing such that, occasionally, large quantities of local crude oil may be transported in bulk away from nearby Eagle Ford Shale. When this occurs, we may experience wider than normal swings in crude oil prices in order to obtain our desired levels of crude oil.

We depend exclusively on GEL for our supply of crude oil and other feedstocks, and the loss of GEL or a material decrease in the supply of crude oil and other feedstocks generally available to the Nixon Facility could have a material adverse effect on our operations and financial condition.

We purchase 100% of our crude oil and other feedstocks exclusively from GEL under the Crude Supply Agreement. We cannot purchase crude oil or other feedstock from another supplier without the consent of GEL. We are dependent on GEL and the loss of GEL would adversely affect our financial results to the extent we were unable to find another supplier of crude oil.

To the extent that GEL reduces the volumes of crude oil and other feedstocks that they supply to us as a result of declining production or competition or otherwise, our sales, net income and cash available for payments of our debt obligations would decline unless we were able to acquire comparable supplies of crude oil and other feedstocks on comparable terms from other suppliers. Fluctuations in crude oil prices can greatly affect production rates and investments by third parties in the development of new oil reserves. Drilling activity generally decreases as crude oil prices decrease. We have no control over the level of drilling activity in the fields that supply the Nixon Facility, the amount of reserves underlying the wells in these fields, the rate at which production from a well will decline or the production decisions of producers. A material decrease in either crude oil production or drilling activity in the fields that supply the Nixon Facility, as a result of depressed commodity prices, natural production declines, governmental moratoriums on drilling or production activities, the availability and the cost of capital or otherwise, could result in a decline in the volume of crude oil we refine.

Loss of market share by a key customer, or consolidation among our customer base, could harm our operating results.

For the year ended December 31, 2013, a large percentage of our revenue, 92%, came from sales to five customers. These customers have a variety of suppliers to choose from and therefore can make substantial demands on us, including demands on product pricing and on contractual terms, which often results in the allocation of risk to us as the supplier. Our ability to maintain strong relationships with our principal customers is essential to our future performance. If we lose a key customer, if any of our key customers reduce their orders of our refined petroleum products or require us to reduce our prices before we are able to reduce costs, if a customer is acquired by one of our competitors or if a key customer suffers financial hardship, our operating results could be harmed.

Additionally, if there is consolidation among our customer base, our customers may be able to command increased leverage in negotiating prices and other terms of sale, which could adversely affect our profitability. In addition, if, as a result of increased leverage, customer pressures require us to reduce our pricing such that our gross margins are diminished, we could decide not to sell our refined petroleum products to a particular customer, which could result in a decrease in our revenue. Consolidation among our customer base may also lead to reduced demand for our products, replacement of our products by the combined entity with those of our competitors and cancellations of orders, each of which could harm our operating results.

The sale of refined petroleum products to the wholesale market is our primary business, and if we fail to maintain and grow our market share or gain market acceptance of our refined petroleum products, our operating results could suffer.

Our success in the wholesale market depends in large part on our ability to maintain and grow our image and reputation as a reliable operator and to expand into and gain market acceptance of our refined petroleum products. Adverse perceptions of product quality, whether or not justified, or allegations of product quality issues, even if false or unfounded, could tarnish our reputation and cause our wholesale customers to choose refined petroleum products offered by our competitors.

We are dependent on third parties for the transportation of crude oil into and refined petroleum products out of our Nixon Facility, and if these third parties become unavailable to us, our ability to process crude oil and sell refined petroleum products to wholesale markets could be materially and adversely affected.

We rely on trucks for the receipt of crude oil into and the sale of refined petroleum products out of our Nixon Facility. Since we do not own or operate any of these trucks, their continuing operation is not within our control. If any of the third-party trucking companies that we use, or the trucking industry in general, become unavailable to transport crude oil or our refined petroleum products because of acts of God, accidents, government regulation, terrorism or other events, our revenue and net income would be materially and adversely affected.

Potential downtime at the Nixon Facility could result in lost margin opportunity, increased maintenance expense, increased inventory, and a reduction in cash available for payment of our obligations.

The safe and reliable operation of the Nixon Facility is key to our financial performance and results of operations. Although currently operating at anticipated levels, the Nixon Facility is still in a recommissioning phase and may require unscheduled downtime for unanticipated reasons, including maintenance and repairs, voluntary regulatory compliance measures, or cessation or suspension by regulatory authorities. Any scheduled or unscheduled downtime may result in lost margin opportunity, increased maintenance expense and a build-up of refined petroleum products inventory, which could reduce our ability to meet our payment obligations.

LEH holds a significant interest in us, and our related party transactions with LEH and its affiliates may cause conflicts of interest that may adversely affect us.

Jonathan P. Carroll, our Chief Executive Officer, President, Assistant Treasurer and Secretary, and Tommy L. Byrd, our interim Chief Financial Officer, Treasurer and Assistant Secretary, are also a member and employee, respectively, of LEH and as a result may, under certain circumstances, have interests that differ from or conflict with our interests. Further, pursuant to the Management Agreement, LEH manages and operates the Nixon Facility and Blue Dolphin's other operations. As a result of their relationship with LEH, Messrs. Carroll and Byrd may experience conflicts of interest in the execution of their duties on behalf of Blue Dolphin including with respect to the Management Agreement.

LEH owns approximately 81% of our outstanding common stock, par value \$0.01 per share (the "Common Stock"). Mr. Carroll is the majority owner of LEH. Through its ownership of such a large amount of Common Stock, LEH has significant influence over matters such as the election of our Board of Directors (the "Board"), control over our business, policies and affairs and other matters submitted to our stockholders. LEH is entitled to vote the Common Stock it owns in accordance with its interests, which may be contrary to our interests and those of other stockholders. LEH has interests that differ from the interests of our stockholders and, as a result, there is a risk that important business decisions will not be made in the best interest of some of our stockholders. LEH and its other affiliates are not limited in their ability to compete with us and are not obligated to offer us business opportunities. We believe that the transactions and agreements that we have entered into with LEH and its affiliates are on terms that are at least as favorable as could reasonably have been obtained at such time from third parties. However, these relationships could create, or appear to create, potential conflicts of interest when our Board is faced with decisions that could have different implications for us and LEH or its affiliates. The appearance of conflicts, even if such conflicts do not materialize, might adversely affect the public's perception of us, as well as our relationship with other companies and our ability to enter into new relationships in the future, which may have a material adverse effect on our ability to do business.

The geographic concentration of our refinery and other assets creates a significant exposure to the risks of the regional economy and other regional adverse conditions. The location of our refinery also creates the risk of significantly increased transportation costs should the supply/demand balance change in our region such that regional supply exceeds regional demand for refined products.

As our refinery and other assets are located in the Eagle Ford Shale and Gulf Coast area of Texas, we primarily market our refined and retail products in a single, relatively limited geographic area. As a result, we are more susceptible to regional economic conditions than the operations of more geographically diversified competitors, and any unforeseen events or circumstances that affect our operating area could also materially adversely affect our revenue. These factors include, among other things, changes in the economy, weather conditions, demographics and population.

Should the supply/demand balance shift in our region as a result of changes in the local economy as discussed above, an increase in refining capacity or other reasons, resulting in supply in the PADD III region of the EIA exceeding demand, we would have to deliver refined products to customers outside of the region and thus incur considerably higher transportation costs, resulting in lower refining margins, if any. Changes in market conditions could have a material adverse effect on our business, financial condition and results of operations.

Competition from companies having greater financial and other resources than we do could materially and adversely affect our business and results of operations.

The refining industry is highly competitive. Our refining operations compete with domestic refiners and marketers in the PADD III region of the United States as defined by the EIA, as well as with domestic refiners in other PADD

regions and foreign refiners that import products into the United States. Certain of our competitors have larger, more complex refineries, and may be able to realize lower per-barrel costs or higher margins per barrel of throughput. Several of our principal competitors are integrated national or international oil companies that are larger and have substantially greater resources than we do and have access to proprietary sources of controlled crude oil production. Unlike these competitors, we obtain all of our feedstocks from a single source. Because of their integrated operations and larger capitalization, these companies may be more flexible in responding to volatile industry or market conditions, such as shortages of crude oil supply and other feedstocks or intense price fluctuations. If we are unable to compete effectively, we may lose existing customers or fail to acquire new customers.

The dangers inherent in our operations could cause disruptions and could expose us to potentially significant losses, costs or liabilities and reduce our liquidity. We are particularly vulnerable to disruptions in our operations because all of our refining operations are conducted at a single facility.

Our operations are subject to significant hazards and risks inherent in refining operations and in transporting and storing crude oil, intermediate products and refined products. These hazards and risks include, but are not limited to, natural disasters, fires, explosions, pipeline ruptures and spills, third party interference and mechanical failure of equipment at our facilities, any of which could result in production and distribution difficulties and disruptions, pollution (such as oil spills, etc.), personal injury or wrongful death claims and other damage to our properties and the property of others.

There is also risk of mechanical failure and equipment shutdowns both in the normal course of operations and following unforeseen events. In such situations, undamaged refinery processing units may be dependent on, or interact with, damaged process units and, accordingly, are also subject to being shut down. Because all of our refining operations are conducted at a single refinery, any such event(s) at our refinery could significantly disrupt our production and distribution of refined products. Any sustained disruption would have a material adverse effect on our business, financial condition, results of operations and cash flows. Additionally, our offshore operations are also subject to a variety of operating risks exclusive to the marine environment such as hurricanes or other adverse weather conditions and restrictive governmental regulation. These regulations may, in certain circumstances, impose strict liability for pollution damage or result in the interruption or termination of operations.

Genesis' hedging of our refined petroleum products may limit our gains and expose us to other risks.

We are exposed to market price risk related to our refined petroleum products inventory. The spread between crude oil and refined product prices is the primary factor affecting our operations, liquidity and financial condition. Our crude acquisition costs and refined petroleum products sales prices depend on numerous factors beyond our control. These factors include the supply of and demand for crude oil, gasoline, NLRM and other refined petroleum products. Supply and demand for these products depend on various factors, including changes in domestic and foreign economies, weather conditions, domestic and foreign political affairs, production levels, availability of imports and exports, marketing of competitive fuels, and government regulation.

In May 2012, we implemented an inventory risk management policy under which Genesis may, but is not required to, use derivative instruments as certain refined product inventories exceed maximum thresholds in an effort to reduce our refined petroleum products inventory commodity price risk. However, Genesis' execution of the inventory risk management plan is outside of our control. Accordingly, there could be situations in which Genesis fails to execute on the plan or executes on the plan in a manner that causes significant losses to us, all of which are beyond our control. In the event that our inventory risk management system fails and/or is implemented poorly or not at all, we could experience a material and negative adverse effect on our operations, liquidity and financial condition.

Our refineries, terminals and related facility operations and other operations face operating hazards, and the potential limits on insurance coverage could expose us to potentially significant liability costs.

Our refinery, terminals and related facility operations and other assets are subject to certain operating hazards, and our cash flow from those operations could decline if any of our facilities experiences a major accident, pipeline rupture or spill, explosion or fire, is damaged by severe weather or other natural disaster, or otherwise is forced to curtail its operations or shut down. These operating hazards could result in substantial losses due to personal injury and/or loss of life, severe damage to and destruction of property and equipment and pollution or other environmental damage and may result in significant curtailment or suspension of our related operations.

Although we maintain insurance policies, including personal and property damage and business interruption insurance for each of our facilities with insurers in amounts and with coverage and deductibles that we, with the advice of our insurance advisors and brokers, believe are reasonable and prudent, we cannot ensure that this insurance will be adequate to protect us from all material expenses related to potential future claims for personal and property damage or significant interruption of operations. Furthermore, we may be unable to maintain or obtain insurance of the type and amount we desire at reasonable rates. As a result of market conditions, premiums and deductibles for certain of our insurance policies have increased and could escalate further. In some instances, certain insurance could become unavailable or available only for reduced amounts of coverage. In addition, we are not fully insured against all risks incident to our business because certain risks are not fully insurable, coverage is unavailable or premium costs, in our judgment, do not justify such expenditures. For example, we are not insured for environmental accidents at all of our facilities.

Our business requires the retention and recruitment of a skilled workforce and the loss of key personnel could result in the failure to implement our business plan.

The success of our business operations depends largely upon the efforts of key executive officers and technical personnel. Given our small size, we may not be able to retain required personnel on acceptable terms due to the competition for experienced personnel from other companies in the industry.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Owned and Leased Assets

We own, lease, and have leasehold interests in the properties listed below:

Property	Business Segment(s)	Acres	Owned / Leased	Location
Nixon Facility	Refinery Operations	56	Owned	Nixon, Wilson County, Texas
Freeport Facility	Pipeline Transportation	193	Owned	Freeport, Brazoria County, Texas
Offshore Pipelines	Pipeline Transportation	--	Owned	U.S. Gulf of Mexico
Oil and Gas Properties	Exploration and Production	--	Leasehold Interest	U.S. Gulf of Mexico
Corporate Headquarters	Corporate and Other	--	Lease	Houston, Harris County, Texas

Nixon Facility – Located in Nixon, Wilson County, Texas, the Nixon Facility is a 56 acre crude oil and condensate processing facility that has a current operating capacity of approximately 15,000 bpd. The Nixon Facility consists of a distillation unit, naphtha stabilizer unit, depropanizer unit, jet fuel treater, approximately 120,000 bbls of crude oil storage capacity, approximately 148,000 bbls of refined product storage capacity and related loading and unloading facilities and utilities. The Nixon Facility is pledged as collateral under a Security Agreement as discussed in Part II, Item 8 “Financial Statements and Supplementary Data – Note (15) Long-Term Debt” of this report.

Freeport Facility – Located in Freeport, Brazoria County, Texas, the Freeport Facility encompasses approximately 193 acres of land and includes pipeline easements and right-of-ways, crude oil and natural gas separation and dehydration facilities, a vapor recovery unit and two onshore pipelines. The two onshore pipelines consist of approximately 4 miles of the 20-inch Blue Dolphin Pipeline and a 16-inch natural gas pipeline that connects the Freeport Facility to the Dow Chemical Plant Complex in Freeport, Texas.

Offshore Pipelines –The following provides a summary of our offshore pipelines, all of which are located in the U.S. Gulf of Mexico:

Pipeline	Location	Ownership	Miles	Natural Gas Capacity (MMcf/d)
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Blue Dolphin Pipeline(1)	U.S. Gulf of Mexico	100%	38	160
GA 350 Pipeline	U.S. Gulf of Mexico	100%	13	65
Omega Pipeline(2)	U.S. Gulf of Mexico	100%	18	110

(1) Currently inactive.

(2) Currently abandoned in place.

- o Blue Dolphin Pipeline System (“Blue Dolphin Pipeline”) – The Blue Dolphin Pipeline consists of 16-inch and 20-inch pipeline segments, including a trunk line and lateral lines, that span approximately 38 miles and run from an offshore anchor platform in Galveston Area Block 288 to our Freeport Facility. The Blue Dolphin Pipeline has an aggregate capacity of approximately 180 MMcf of gas and 7,000 Bbls of crude oil and condensate per day;
- o Galveston Area Block 350 Pipeline (the “GA 350 Pipeline”) – The GA 350 Pipeline is an 8-inch, 13 mile offshore pipeline extending from Galveston Area Block 350 to a subsea interconnect and tie-in with a transmission pipeline in Galveston Area Block 391. The GA-350 Pipeline has a capacity of approximately 65 MMcf of gas per day; and
- o Omega Pipeline (the “Omega Pipeline”) – The Omega Pipeline is a 12-inch, 18 mile offshore pipeline that originates in the High Island Area, East Addition Block A-173 and extends to West Cameron Block 342, where it was previously connected to the High Island Offshore System. The Omega Pipeline was abandoned in place in 1997. Reactivation of the Omega Pipeline is dependent upon future drilling activity in its vicinity and the successful attraction of producer/shippers to the system. When it was active, the Omega Pipeline had a capacity of approximately 110 MMcf of gas per day.

Oil and Gas Properties – Oil and gas properties include a 2.5% working interest and 2.008% net revenue interest in High Island Block 115, a 0.5% overriding royalty interest in Galveston Area Block 321, and a 2.88% working interest and 2.246% net revenue interest in High Island Block 37. All of the leases associated with these oil and gas properties have expired.

Corporate Headquarters – We lease 6,489 square feet of office space in Houston, Harris County, Texas, which serves as our company headquarters. Our office lease is discussed more fully in Part II, Item 8 “Financial Statements and Supplementary Data – Note (19) Leases” included in this Annual Report on Form 10-K.

LEH manages and operates all of our properties and is reimbursed for their management and operation under the Management Agreement. We believe that our properties are generally adequate for our operations and are maintained in a good state of repair in the ordinary course of business.

Options to Purchase Assets

LTRI Option -- In June 2012, we purchased an exclusive option from LEH to acquire all of the issued and outstanding membership interests of Lazarus Texas Refinery I, LLC (“LTRI”), a Delaware limited liability company and a wholly-owned subsidiary of LEH. LTRI’s assets include a refinery, located on a 104 acre site in Ingleside, San Patricio County, Texas (the “Ingleside Refinery”). The Ingleside Refinery consists of crude oil and condensate processing equipment, pipeline connections, trucking terminals and related storage, storage tanks, a barge dock and receiving facility, pipelines, equipment, related loading and unloading facilities and utilities. The LTRI Option expired on December 31, 2013; however, the parties are in discussions related to the terms for extending the option. Although the contemplated transaction is with a related party, the Board has determined that the contemplated transaction is advisable, fair to and in the best interests of our stockholders.

In the event we exercise the option to purchase the Ingleside Refinery, Blue Dolphin and LEH will enter into a definitive purchase and sale agreement. We paid LEH a fully refundable sum of \$100,000 in cash as consideration to purchase the exclusive option. Upon exercise of the exclusive option to purchase the Ingleside Refinery, we will assume all outstanding liabilities, including a note payable, and reimburse LEH for costs associated with the acquisition, refurbishment and environmental remediation of the site. The parties continue to monitor such refurbishment and remediation efforts as a prerequisite to determining the purchase price. If there is a material difference between LEH’s expenditures for such remediation efforts and our desired purchase price, LEH has agreed to

refund us the purchase price for the Ingleside Refinery option.

LED Option – In connection with the LE Acquisition, we purchased an exclusive option from LEH to acquire all of the issued and outstanding membership interests of Lazarus Energy Development, LLC (“LED”), a Delaware limited liability company and a wholly-owned subsidiary of LEH. LED owns approximately 46 acres of real property, which is located adjacent to the Nixon Facility in Nixon, Wilson County, Texas. We paid LEH a fully refundable sum of \$183,421 in cash as consideration to purchase this option. The LED Option expired on December 31, 2013; however, the parties are in discussions related to the terms for extending the option. Although the contemplated transaction is with a related party, the Board has determined that the contemplated transaction is advisable, fair to and in the best interests of our stockholders.

ITEM 3. LEGAL PROCEEDINGS

From time to time we are subject to various lawsuits, claims, liens and administrative proceedings that arise out of the normal course of business. Vendors have placed mechanic's liens on the Nixon Facility as protection during construction activities. Management does not believe that such liens have a material adverse effect on our results of operations.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

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PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND
ISSUER
PURCHASES OF EQUITY SECURITIES

Market Information

Simultaneous with the delisting of our Common Stock from the Nasdaq Capital Market on February 28, 2012, our Common Stock began trading on the OTCQX U.S. Premier tier of the OTC Markets under the ticker symbol "BDCO." The following table sets forth, for the periods indicated, the high and low prices for our Common Stock as reported by the NASDAQ and the OTC Markets. The quotations reflect inter-dealer prices, without adjustment for retail mark-ups, markdowns or commissions and may not represent actual transactions.

Quarter Ended	High	Low
2013		
December 31	\$6.90	\$ 4.15
September 30	\$7.00	\$ 5.01
June 30	\$6.49	\$ 5.12
March 31	\$9.97	\$ 5.00
2012		
December 31	\$6.50	\$ 3.85
September 30	\$7.95	\$ 6.01
June 30	\$9.22	\$ 6.18
March 31	\$11.60	\$ 4.28

Holders

As of March 31, 2014, we had approximately 280 record holders of our Common Stock. We have approximately 3,000 beneficial holders of our Common Stock.

Dividends

We have not declared or paid any dividends on our Common Stock since our incorporation. We currently intend to retain earnings for our capital needs and expansion of our business and do not anticipate paying cash dividends on the Common Stock in the foreseeable future. We expect that any loan agreements we enter into in the future will likely contain restrictions on the payment of dividends on our Common Stock. Future policy with respect to dividends will be determined by the Board based upon our earnings and financial condition, capital requirements and other considerations.

ITEM 6. SELECTED FINANCIAL DATA

Not applicable.

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

The following is a review of certain aspects of our financial condition and results of operations and should be read in conjunction with “Part I, Item 1. Business” and “Part II, Item 8. Financial Statements and Supplementary Data” including the associated “Notes to Consolidated Financial Statements” of this report.

Executive Summary

Our primary business is the refining of crude oil and condensate into marketable finished and intermediate products at the Nixon Facility, which is a crude oil and condensate processing facility with a current operating capacity of approximately 15,000 barrels (“bbls”) per day (“bpd”). The Nixon Facility is located on a 56 acre site in Nixon, Wilson County, Texas, and consists of a distillation unit, naphtha stabilizer unit, depropanizer unit, jet fuel treater, approximately 120,000 bbls of crude oil storage capacity, approximately 148,000 bbls of refined product storage capacity and related loading and unloading facilities and utilities. As part of our refinery business segment we also conduct petroleum storage and terminaling operations under third-party lease agreements at the Nixon Facility. We also own and operate pipeline assets and have leasehold interests in oil and gas properties.

Refinery Operations Business Strategy

We are dedicated to maintaining safe, efficient and reliable refinery operations, improving liquidity and profitability, and focusing on safety and environmental stewardship. Throughout 2013, we took a number of steps to more effectively operate the Nixon Facility and manage the spread between our cost to acquire crude oil and the price of the refined petroleum products that we ultimately sell, as follows:

Safety and Environmental Management – We implemented programs and procedures across the company for managing safety and environmental matters with a focus on the assignment of responsibilities, sound risk management and decision-making, efficient and cost-effective planning and operations and regulatory compliance. We also completed an assessment of process safety management (“PSM”) standards at the Nixon Facility. Improving our PSM standards and developing a PSM program at the Nixon Facility, which is designed to address all aspects of OSHA guidelines for developing and maintaining a comprehensive PSM program, is an integral part of our safety and environmental management strategy going forward;

Improved Product Mix – The Nixon Facility began producing jet fuel – the Nixon Facility’s fifth commercially saleable product – in mid-September 2013. Jet fuel is produced by separating the distillate stream into kerosene and diesel and blending the kerosene with a portion of the heavy naphtha stream. Production of jet fuel, which is considered a higher value product, significantly upgrades the value of the naphtha component. We plan to significantly increase the production of jet fuel during 2014;

Naphtha Stabilizer and Depropanizer Units Refurbishment – We continued the refurbishment of certain components of the Nixon Facility, including the naphtha stabilizer and depropanizer units at the Nixon Facility, which we anticipate will: (i) improve the overall quality of the naphtha that we produce, (ii) allow higher recovery of lighter products that can be sold as a liquefied petroleum gas (“LPG”) mix, and (iii) increase the amount of throughput that can be processed by the Nixon Facility. The estimated cost to refurbish the naphtha stabilizer and depropanizer units is approximately \$1.5 million; and

Nixon Facility Improvements – We continued to enhance our condition-based predictive maintenance turnaround policy and completed several smaller capital improvement projects at the Nixon Facility, such as installing new laboratory equipment and a new caustic system and upgrading loading bay meters.

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Key Operating Statistics

Key operational statistics for our core business segment, refinery operations, were as follows:

	Year Ended December 31,	
	2013	2012
Operating days	341	326
Total refinery throughput(1)		
bbls	3,822,128	3,176,530
bpd	11,209	9,744
Capacity utilization rate	75 %	65 %
Total refinery production		
bbls	3,743,482	3,116,650
bpd	10,978	9,560
Capacity utilization rate	73 %	64 %

(1) Total refinery throughput includes crude oil and condensate and other feedstocks.

Major Influences on Results of Operations

The safe, efficient and reliable operation of the Nixon Facility is critical to our financial performance. Any adverse financial impact of a maintenance turnaround or significant capital improvement project is mitigated through a diligent planning process that considers expectations for product availability, seasonality, margin environment and the availability of resources to perform the required work. Periodic maintenance and repairs are generally performed annually, depending on the processing units involved.

Earnings and cash flow from our refining operations are primarily affected by the difference between refined product prices and the prices for crude oil and other feedstocks. The cost to acquire crude oil and other feedstocks and the price of the refined petroleum products we ultimately sell depend on numerous factors beyond our control, including the supply of, and demand for, crude oil, gasoline and other refined petroleum products, which, in turn, depend on, among other factors, changes in domestic and foreign economies, weather conditions, domestic and foreign political affairs, production levels, availability of imports, marketing of competitive fuels and government regulation.

We monitor our per barrel refinery operating margins in order to measure our operating performance. We calculate the per barrel operating margin for the Nixon Facility by dividing the refinery's gross margin by its throughput volumes. Gross margin is the difference between net sales and cost of sales (excluding any substantial unrealized hedge positions and certain inventory adjustments).

The Nixon Facility is capable of processing substantial volumes of low-sulfur crude oil (sweet crude) and condensate to produce a high percentage of light, higher valued refined petroleum products. Sweet crude and condensate derived from surrounding Eagle Ford Shale production currently comprises 100% of the Nixon Facility's input.

The nature of our business requires us to maintain access to substantial quantities of crude oil and refined product inventories. Crude oil and refined petroleum products are essentially commodities, and we have no control over the changing market value of these inventories. We utilize an inventory risk management policy in which derivative

instruments may be used as economic hedges to reduce our crude oil and refined petroleum products inventory commodity price risk.

Relationship with Genesis

We continue to be dependent on our relationship with Genesis and its affiliates. Our relationship with Genesis is governed by three agreements:

the Crude Oil Supply and Throughput Services Agreement by and between GEL and LE dated August 12, 2011 (the “Crude Supply Agreement”);

the Construction and Funding Contract by and between LE and Milam, an affiliate of Genesis, dated August 12, 2011 (the “Construction and Funding Agreement”); and

the Joint Marketing Agreement by and between GEL and LE dated August 12, 2011 (as subsequently amended, the “Joint Marketing Agreement”).

Below is a discussion of the material terms and conditions of each of our agreements with Genesis.

Crude Supply Agreement. Pursuant to the Crude Supply Agreement, GEL, an affiliate of Genesis, is the exclusive supplier of crude oil to the Nixon Facility. We are not permitted to buy crude oil from any other source without GEL’s express written consent. GEL supplies crude oil to LE at cost plus freight expense and any costs associated with GEL’s hedging. All crude oil supplied to LE pursuant to the Crude Supply Agreement is paid for pursuant to the terms of the Joint Marketing Agreement as described below. In addition, GEL has a first right of refusal to use three storage tanks at the Nixon Facility during the term of the Crude Supply Agreement. Subject to certain termination rights, the Crude Supply Agreement has an initial term of three years, expiring on August 12, 2014. In accordance with the terms of the October 2013 Letter Agreement, LE agreed not to terminate the Crude Supply Agreement and GEL agreed to automatically renew the Crude Supply Agreement at the end of the initial term for successive one year periods until August 12, 2019 unless sooner terminated by GEL with 180 days prior written notice.

Construction and Funding Agreement. Pursuant to the Construction and Funding Agreement, LE engaged Milam to provide construction services on a turnkey basis in connection with the construction, installation and refurbishment of certain equipment at the Nixon Facility (the “Project”). Milam has continued to make advances in excess of their obligation, for certain construction and operating costs at the Nixon Facility. All amounts advanced to LE pursuant to the terms of the Construction and Funding Agreement bear interest at a rate of 6% per annum. In March 2012 (the month after initial operation of the Nixon Facility occurred), LE began paying Milam, in accordance with the provisions of the Joint Marketing Agreement, a minimum monthly payment of \$150,000 (the “Base Construction Payment”) as repayment of interest and amounts advanced to LE under the Construction and Funding Agreement. If, however, the Gross Profits of LE (as defined below) in any given month (calculated as the revenue from the sale of products from the Nixon Facility minus the cost of crude oil) are insufficient to make this payment, then there is a deficit amount, which shall accrue interest (the “Deficit Amount”). If there is a Deficit Amount, then 100% of the gross profits in subsequent calendar months will be paid to Milam until the Deficit Amount has been satisfied in full and all previous \$150,000 monthly payments have been made.

The Construction and Funding Agreement places restrictions on LE, which prohibit LE from: (i) incurring any debt (except debt that is subordinated to amounts owed to Milam or GEL); (ii) selling, discounting or factoring its accounts receivable or its negotiable instruments outside the ordinary course of business while no default exists; (iii) suffering any change of control or merging with or

into another entity; and (iv) certain other conditions listed therein. As of the date hereof, Milam can terminate the Construction and Funding Agreement by written notice at any time. If Milam terminates the Construction and Funding Agreement, then Milam and LE are required to execute a forbearance agreement, the form of which has previously been agreed to as Exhibit J of the Construction and Funding Agreement.

In accordance with the terms of the October 2013 Letter Agreement, GEL agreed to advance to LE monies not to exceed approximately \$186,934 to pay for certain equipment and services at the Nixon Facility. All amounts advanced or paid by GEL or its affiliates pursuant to the October 2013 Letter Agreement will constitute Obligations, as defined in the Construction and Funding Agreement, by LE to Milam under the Construction and Funding Agreement.

Joint Marketing Agreement. The Joint Marketing Agreement sets forth the terms of the agreement between LE and GEL pursuant to which the parties will market and sell the output produced at the Nixon Facility and share the Gross Profits (as defined below) from such sales. Pursuant to the Joint Marketing Agreement, GEL is responsible for all product transportation scheduling. LE is responsible for entering into contracts with customers for the purchase and sale of output produced at the Nixon Facility and handling all billing and invoicing relating to the same. However, all payments for the sale of output produced at the Nixon Facility will be made directly to GEL as collection agent and all customers must satisfy GEL's customer credit approval process. Subject to certain amendments and clarifications (as described below), the Joint Marketing Agreement also provides for the sharing of "Gross Profits" (defined as the total revenue from the sale of output from the Nixon Facility minus the cost of crude oil pursuant to the Crude Supply Agreement) as follows:

- (a) First, prior to the date on which Milam has recouped all amounts advanced to LE under the Construction and Funding Agreement (the “Investment Threshold Date”), the Base Construction Payment of \$150,000 shall be paid to GEL (for remittance to Milam) each calendar month to satisfy amounts owed under the Construction and Funding Agreement, with a catch-up in subsequent months if there is a Deficit Amount until such Deficit Amount has been satisfied in full.
- (b) Second, prior to and as of the Investment Threshold Date, LE is entitled to receive weekly payments to cover direct expenses in operating the Nixon Facility (the “Operations Payments”) in an amount not to exceed \$750,000 per month plus the amount of any Accounting Fees. If Gross Profits are less than \$900,000, then LE’s Operations Payments shall be reduced to equal to the difference between the Gross Profits for such monthly period and the proceeds discussed in (a) above; if Gross Profits are negative, then LE does not get an Operations Payment and the negative balance becomes a Deficit Amount which is added to the total due and owing under the Construction Funding Agreement and such Deficit Amount must be satisfied before any allocation of Gross Profit in the future may be made to LE.
- (c) Third, prior to the Investment Threshold Date and subject to the payment of the Base Construction Payment by LE and the Operations Payments by GEL, pursuant to (a) and (b) above, an amount shall be paid to GEL from Gross Profits equal to transportation costs, tank storage fees (if applicable), financial statement preparation fees (collectively, the “GEL Expense Items”), after which GEL shall be paid 80% of the remaining Gross Profits (any percentage of Gross Profits distributed to GEL, the “GEL Profit Share”) and LE shall be paid 20% of the remaining Gross Profits (any percentage of Gross Profits distributed to LE, the “LE Profit Share”); provided, however, that in the event that there is a forbearance payment of Gross Profits required by LE under a forbearance agreement with a bank, then 50% of the LE Profit Share shall be directly remitted by GEL to the bank on LE’s behalf until such forbearance amount is paid in full; and provided further that, if there is a Deficit Amount due under the Construction and Funding Agreement and a forbearance payment of Gross Profits that would otherwise be due and payable to the bank for such period, then GEL shall receive 80% of the Gross Profit and 10% shall be payable to the bank and LE shall not receive any of the LE Profit Share until such time as the Deficit Amount is reduced to zero.
- (d) Fourth, after the Investment Threshold Date and after the payment to GEL of the GEL Expense Items, 30% of the remaining Gross Profit up to \$600,000 (the “Threshold Amount”) shall be paid to GEL as the GEL Profit Share and LE shall be paid 70% of the remaining Gross Profit as the LE Profit Share. Any amount of remaining Gross Profit that exceeds the Threshold Amount for such calendar month shall be paid to GEL and LE in the following manner: (i) GEL shall be paid 20% of the remaining Gross Profits over the Threshold Amount as the GEL Profit Share and (ii) LE shall be paid 80% of the remaining Gross Profits over the Threshold Amount as the LE Profit Share.
- (e) After the Investment Threshold Date, if GEL sustains losses, it can recoup those losses by a special allocation of 80% of Gross Profits until such losses are covered in full, after which the prevailing Gross Profits allocation shall be reinstated.

The Joint Marketing Agreement contains negative covenants that restrict LE’s actions under certain circumstances. For example, LE is prohibited from making any modifications to the Nixon Facility or entering into any contracts with third-parties that would materially affect or impair GEL’s or its affiliates’ rights under the agreements set forth above. The Joint Marketing Agreement has an initial term of three years expiring on August 12, 2014. In accordance with the terms of the October 2013 Letter Agreement, LE agreed not to terminate the Joint Marketing Agreement and GEL agreed to automatically renew the Joint Marketing Agreement at the end of the initial term for successive one year periods until August 12, 2019 unless sooner terminated by GEL with 180 days prior

written notice.

Amendments and Clarifications to the Joint Marketing Agreement. The Joint Marketing Agreement was amended and clarified to allow GEL to provide LE with Operations Payments during months in which LE incurred Deficit Amounts.

- (a) In July and August 2012, we entered into amendments to the Joint Marketing Agreement whereby GEL and Milam agreed that Deficit Amounts would be added to our obligation amount under the Construction and Funding Agreement. In addition, the parties agreed to amend the priority of payments to reflect that, to the extent that there are available funds in a particular month, AFNB shall be paid one-tenth of such funds, provided that we will not participate in available funds until Deficit Amounts added to the Construction and Funding Agreement are paid in full.

- (b) In December 2012, GEL made Operations Payments and other payments to or on behalf of LE in which the aggregate amount exceeded the amount payable to LE in the month of December 2012 under the Joint Marketing Agreement (the "Overpayment Amount"). In December 2012, we entered into an amendment to the Joint Marketing Agreement whereby GEL and Milam agreed that Gross Profits payable to LE would be redirected to GEL as payment for the Overpayment Amount until such Overpayment Amount has been satisfied in full. Such redistributions shall not reduce the distributions of Gross Profit that GEL or Milam are otherwise entitled to under the Joint Marketing Agreement.
- (c) In February 2013, Milam paid a vendor \$64,358 (the "Settlement Payment"), which represented amounts outstanding by LE for services rendered at the Nixon Facility plus the vendor's legal fees. In addition, Milam and GEL incurred legal fees and expenses related to settling the matter. In a letter agreement between LE, GEL and Milam dated February 21, 2013, the parties agreed to modify the Joint Marketing Agreement such that, from and after January 1, 2013, the Gross Profit shall be distributed first to GEL, prior to any other distributions or payments to the parties to the Joint Marketing Agreement until GEL has received aggregate distributions as provided in the December 2012 Letter Agreement plus the Settlement Payment and Milam and GEL incurred legal fees and expenses.
- (d) In February 2013, GEL agreed to advance to LE the funds necessary to pay for the actual costs incurred for the scheduled maintenance turnaround at the Nixon Facility and capital expenditures relating to an electronic product meter, lab equipment and certain piping in an amount equal to the actual costs of the refinery turnaround and capital expenditures, not to exceed \$840,000 in the aggregate. In a letter agreement between LE, GEL and Milam dated February 21, 2013, the parties agreed that all amounts advanced by GEL or its affiliates to LE pursuant to the letter agreement shall constitute obligations under the Construction and Funding Agreement.

As of December 31, 2013, total advances under the Construction and Funding Agreement, including Deficit Amounts, were \$5,747,330. As of December 31, 2013, pursuant to amendments and clarifications to the Joint Marketing Agreement, the net Deficit Amount included in our obligation amount under the Construction and Funding Agreement was \$2,538,077.

Results of Operations

Year Ended December 31, 2013 (the "Current Year") Compared to Year Ended December 31, 2012 (the "Prior Year").

The Nixon Facility was refurbished and began operations in February 2012. The Nixon Facility operated for a total of 341 days at 75% of operating capacity during the Current Year. The Nixon Facility operated for a total of 326 days at 65% of operating capacity during the Prior Year.

Summary. For the Current Year we reported a loss from continuing operations, net of tax, of \$3,807,129, or a loss of \$0.36 per share, compared to a loss from continuing operations, net of tax, of \$13,841,066, or a loss of \$1.35 per share, for the Prior Year. We reported a loss from discontinued operations of \$4,443,566, or a loss of \$0.43 per share, in the Prior Year compared to no loss from discontinued operations in the Current Year. The loss from continuing operations, net of tax, in the Current Year was primarily attributable to lower refining margins. The Nixon Facility, which was returned to service in February 2012, operated for 15 more days and had an increase in total refinery throughput of approximately 10% in the Current Year compared to the Prior Year. However, for the same period: (i) the average price per barrel of crude oil was higher, (ii) the average sales price per barrel of our refined products sold was lower, and (iii) the Nixon Facility was operating less than optimally. During the Current Year, we adopted a condition-based predictive maintenance turnaround policy and completed several smaller capital improvement projects at the Nixon Facility, including installing new laboratory equipment and a new caustic system and updating

the meters at the loading bays, to improve the operating efficiency of the Nixon Facility. We will continue to make facility improvements to further optimize capacity utilization rates and improve product yields.

The safe and reliable operation of the Nixon Facility is key to our financial performance and results of operations. Downtime may result in lost margin opportunity, increased maintenance expense, increased inventory, and a reduction in cash available for payment of our obligations. The Nixon Facility experienced 25 calendar days of downtime in the Current Year. During the first quarter of the Current Year, the Nixon Facility experienced 14 calendar days of scheduled downtime for a planned maintenance turnaround. During the fourth quarter of the Current Year, the Nixon Facility experienced 9 calendar days of unscheduled downtime for maintenance and a review, at management's voluntarily election, of compliance with regulatory record keeping requirements. The Nixon Facility experienced 40 calendar days of scheduled and unscheduled downtime in the Prior Year related start-up maintenance. See "Part I, Item 1A. Risk Factors" in in this report for risk factors related to Nixon Facility downtime.

Total Revenue from Operations. For the Current Year we had total revenue from operations of \$409,543,069 compared to total revenue from operations of \$352,094,714 for the Prior Year. The increase in total revenue from operations was primarily the result of operating 15 more days and increased throughput at the Nixon Facility in the Current Year compared to the Prior Year. Substantially all of our revenue in the Current Year came from refined product sales, which generated revenue of \$409,239,747, or more than 99% of total revenue from operations, compared to \$351,665,234, or more than 99% of total revenue from operations, in the Prior Year.

Cost of Refined Products Sold. Cost of refined petroleum products sold was \$399,101,182 for the Current Year compared to \$342,035,755 for the Prior Year. The increase in cost of refined products sold was primarily the result of operating 15 more days and increased throughput at the Nixon Facility in the Current Year compared to the Prior Year.

Refinery Operating Expenses. We recorded refinery operating expenses of \$10,673,722 in the Current Year, all of which were for services provided to us by LEH to manage and operate Blue Dolphin's assets pursuant to the Management Agreement with LEH. For the Prior Year, we recorded refinery operating expenses of \$8,603,155. See "Part I, Item 1. Financial Statements - Note (11), Accounts Payable, Related Party" of this report for additional disclosures related to the Management Agreement.

Pipeline Operating Expenses. We recorded pipeline operating expenses of \$163,163 in the Current Year compared to \$391,169 in the Prior Year. The decline in pipeline operating expenses was the result of lower throughput on our pipeline systems.

Lease Operating Expenses. Lease operating expenses totaled \$67,923 in the Current Year compared to \$57,122 in the Prior Year.

General and Administrative Expenses. We incurred general and administrative expenses of \$1,794,053 in the Current Year compared to \$2,076,946 in the Prior Year. The decrease in general and administrative expenses in the Current Year was primarily related to lower consulting, legal and audit expenses.

Depletion, Depreciation and Amortization. We recorded depletion, depreciation and amortization expenses of \$1,342,563 in the Current Year compared to \$1,622,864 in the Prior Year. We recorded a significant impairment to our pipeline and oil and gas assets in 2012, which reduced the carrying value of these assets and resulted in a corresponding decrease in depletion, depreciation and amortization expense.

Abandonment Expense. We recognized \$63,767 of abandonment expense in the Current Year compared to \$1,184,549 in the Prior Year. Abandonment expense in the Prior Year primarily related to plugging and abandonment costs associated with our High Island A-7 oil and gas property. We will record additional plugging and abandonment costs for oil and gas properties as information becomes available from operators to substantiate actual and/or probable costs.

Impairment. Due to the continued weakness in our pipeline transportation and oil and gas exploration production business segments and the uncertainty of the timing and speed of recovery, we recorded an impairment of \$9,435,745 in the Prior Year. The impairment charge in the Prior Year consisted of \$7,990,025 related to our pipeline fixed assets and \$1,445,720 related to goodwill, 100% of which was associated with our pipeline transportation and oil and gas exploration production business segments. We recorded \$0 in impairment charges in the Current Year. See "Intangibles – Goodwill and Other" and "Recently Adopted Accounting Guidance" in "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" for additional information related to goodwill, other intangible assets, impairment of goodwill and impairment of long-lived assets.

Other Income. We recognized \$1,155,064 in net tank rental revenue in the Current Year compared to \$534,047 in the Prior Year. The increase in net tank rental revenue was primarily a result of additional tanks being leased to customers.

Discontinued Operations, Net of Tax. We reported a loss from discontinued operations, net of tax, of \$4,443,566 in the Prior Year compared to \$0 in the Current Year. On November 6, 2012, BDEX entered into a Sale and Purchase Agreement with Blue Sky to dispose of its 7% undivided working interest in Indonesia. As a result, our operations related to Indonesia ceased effective November 6, 2012 and the disposal was completed on February 28, 2013.

Earnings Before Interest, Income Taxes and Depreciation (“EBITDA”)

Management uses EBITDA, a non-GAAP financial measure, to assess the operating results and effectiveness of our business segments, which consist of our consolidated businesses and investments. We believe EBITDA is useful to our investors because it allows them to evaluate our operating performance using the same performance measure analyzed internally by management. EBITDA is adjusted for: (i) items that do not impact our income or loss from continuing operations, such as the impact of accounting changes, (ii) income taxes and (iii) interest income (expense), depreciation and amortization. We exclude interest expense (or income) and other expenses or income not pertaining to the operations of our segments from this measure so that investors may evaluate our current operating results without regard to our financing methods or capital structure. We understand that EBITDA may not be comparable to measurements used by other companies. Additionally, EBITDA should be considered in conjunction with net income (loss) and other performance measures such as operating cash flows.

Following is a reconciliation of EBITDA by business segment for the year ended December 31, 2013 (and at December 31, 2013) and the year ended December 31, 2012 (and at December 31, 2012):

	Year Ended December 31, 2013				Total
	Segment				
	Refinery Operations	Pipeline Transportation	Oil and Gas Exploration & Production	Corporate and Other	
Revenue	\$409,239,747	\$ 303,122	\$200	\$-	\$409,543,069
Operation cost(1)	(409,800,285)	(377,245)	(146,806)	(1,652,160)	(411,976,496)
Other non-interest income	1,113,397	41,667	-	-	1,155,064
EBITDA	\$552,859	\$ (32,456)	\$(146,606)	\$(1,652,160)	\$(1,278,363)
Depletion, depreciation and amortization					(1,342,563)
Other expense, net					(1,096,948)
Loss from continuing operations, before income taxes					\$(3,717,874)
Capital expenditures	\$1,477,729	\$ -	\$-	\$-	\$1,477,729
Identifiable assets(2)	\$54,470,723	\$ 2,378,806	\$20,661	\$809,311	\$57,679,501

(1) Within operation cost, general and administrative expenses are allocated across business segments based on revenue. General and administrative expenses associated with corporate maintenance costs (such as director fees and legal expenses) are included in the Corporate and Other business segment. The effect of economic hedges on our refined petroleum products and crude oil inventory, which are executed by Genesis, is included within the operation cost of our Refinery Operations business segment. Cost of refined products sold includes a realized loss of \$246,210 and an unrealized gain of \$143,050.

Identifiable assets contain related legal obligations of each business segment including cash, accounts receivable (2) and recorded net assets.

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Year Ended December 31, 2012

	Segment				Total
	Refinery Operations	Pipeline Transportation	Oil and Gas Exploration & Production	Corporate and Other	
Revenues	\$351,665,234	\$ 406,812	\$22,668	\$-	\$352,094,714
Operation cost(1)	(350,940,269)	(8,676,242)	(2,018,126)	(2,270,009)	(363,904,646)
Other non-interest income	534,047	-	-	-	534,047
EBITDA	\$1,259,012	\$ (8,269,430)	\$(1,995,458)	\$(2,270,009)	\$(11,275,885)
Depletion, depreciation and amortization					(1,622,864)
Other expense, net					(932,639)
Loss from continuing operations, before income taxes					\$(13,831,388)
Loss from discontinued operations					\$(4,443,566)
Capital expenditures	\$2,852,460	\$ -	\$-	\$-	\$2,852,460
Identifiable assets(2)	\$52,745,767	\$ 1,861,055	\$48,247	\$1,726,857	\$56,381,926

(1) Within operation cost, general and administrative expenses are allocated across business segments based on revenue. General and administrative expenses associated with corporate maintenance costs (such as director fees and legal expenses) are included in the Corporate and Other business segment. The effect of economic hedges on our refined petroleum products and crude oil inventory, which are executed by Genesis, is included within the operation cost of our Refinery Operations business segment. Cost of refined products sold includes a realized loss of \$90,507 and an unrealized loss of \$136,100. Impairment expenses of \$7,990,025 related to our pipeline fixed assets and \$1,445,720 related to goodwill are included within the operation cost of our Pipeline Transportation and Corporate and Other business segments, respectively.

Identifiable assets contain related legal obligations of each business segment including cash, accounts receivable (2) and payable and recorded net assets.

Critical Accounting Policies

Long Lived Assets.

Refinery and Facilities. Additions to refinery and facilities are capitalized. Expenditures for repairs and maintenance, including maintenance turnarounds, are included in the Management Agreement and covered by LEH (see "Part II, Item 8. Financial Statements and Supplementary Data – Note (11) Accounts Payable, Related Party" in this report for additional disclosures related to the Management Agreement). Management expects to continue making improvements to the Nixon Facility based on technological advances.

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

of operations.

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

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

Oil and Gas Properties. We account for our oil and gas properties using the full-cost method of accounting, whereby all costs associated with acquisition, exploration and development of oil and gas properties, including directly related internal costs, are capitalized on a cost center basis. Amortization of such costs and estimated future development costs are determined using the unit-of-production method. Our U.S. Gulf of Mexico oil and gas properties were uneconomical for the years ended December 31, 2013 and 2012 due to leases being relinquished and fields being shut-in by operators. We disposed of our operations in Indonesia in 2012.

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

Construction in Progress. Construction in progress expenditures related to refurbishment activities at the Nixon Facility are capitalized as incurred. Depreciation begins once the asset is placed in service.

Goodwill. We recognized goodwill in connection with our reverse merger with LE in 2012. Goodwill has an indefinite useful life and represents the difference between the total purchase price and the fair value of assets (tangible and intangible) and liabilities at the date of acquisition and is reviewed for impairment annually, and more frequently as circumstances warrant, and written down only in the period in which the recorded value of such assets exceed their fair value. We do not amortize goodwill in accordance with FASB ASC guidance related to intangibles, goodwill and other. We perform an impairment test annually in the fourth quarter.

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

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

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

The second step of the process involves the calculation of an implied fair value of goodwill for each reporting unit for which step one indicated impairment. The implied fair value of goodwill is determined by measuring the excess of the estimated fair value of the reporting unit over the estimated fair values of the individual assets, liabilities and identifiable intangibles as if the reporting unit was being acquired in a business combination. If the implied fair value of goodwill exceeds the carrying value of goodwill assigned to the reporting unit, there is no impairment. If the

carrying value of goodwill assigned to a reporting unit exceeds the implied fair value of the goodwill, an impairment charge is recorded for the excess. An impairment loss cannot exceed the carrying value of goodwill assigned to a reporting unit and the subsequent reversal of goodwill impairment losses is not permitted. The determination of fair value required us to make significant estimates and assumptions. These estimates and assumptions primarily included, but were not limited to, revenue growth and operating earnings projections, discount rates, growth rates and required capital expenditure projections. Due to the inherent uncertainty involved in making these estimates, actual results could have differed materially from our estimates. As a result of our evaluation, we recognized a non-cash impairment charge of \$1,445,720 related to goodwill during the fourth quarter of 2012. The impairment recognized during 2012 represented 100% of goodwill.

Other Intangible Assets. We recognized trade name in connection with our reverse merger with LE in 2012. We have determined our trade name to have an indefinite useful life. We account for other intangible assets under FASB ASC guidance related to intangibles, goodwill and other. Under the guidance, intangible assets with indefinite lives are tested annually for impairment. Management performed its regular annual impairment testing of trade name following FASB ASC guidance for determining impairment. Upon completion of that testing, we determined that no impairment was necessary as of December 31, 2013.

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

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

Revenue from tank storage rental is recorded monthly in accordance with the terms of the related lease agreement. The lessee is invoiced monthly for the amount of rent due for the related period.

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

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

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

Recently Adopted Accounting Guidance

The guidance issued by the FASB during the year ended December 31, 2013 is not expected to have a material effect on our consolidated financial statements.

Liquidity and Capital Resources

Sources and Uses of Cash.

	Three Months Ended		Year Ended December 31,	
	December 31, 2013	2012	2013	2012
Cash flow from operations				
Adjusted loss from continuing operations	\$4,691,841	\$2,736,327	\$(2,287,900)	\$(1,831,753)
Adjusted loss from discontinued operations	-	(435,460)	-	(435,460)
Change in assets and current liabilities	892,524	811,739	3,311,718	2,334,540
Total cash flow from operations	5,584,365	3,112,606	1,023,818	67,327
Cash inflows (outflows)				
Proceeds from issuance of debt	-	(2,563,062)	5,750,611	4,788,623
Payments on long term debt	(5,213,230)	-	(5,274,106)	(3,276,748)
Cash acquired on Acquisition	-	115	-	1,674,709
Capital expenditures	(232,870)	(284,011)	(1,477,729)	(2,852,460)
Proceeds from sale of assets	-	-	201,000	-
Proceeds from notes payable	-	-	15,032	24,548
Payments on note payable	(18,360)	(4,025)	(224,805)	(26,925)
Proceeds from exercise of stock options	-	20,000	-	20,000
Total cash inflows (outflows)	(5,464,460)	(2,830,983)	(1,009,997)	351,747
Total change in cash flows	\$119,905	\$281,623	\$13,821	\$419,074

At December 31, 2013, our available cash was \$434,717. We are currently relying on our profit share, GEL and LEH to fund our working capital requirements. During months in which we receive no profit share distribution, GEL and/or LEH may, but are not required to, fund our operating losses. As of December 31, 2013, the Deficit Amount financed by GEL was \$2,538,077 and the working capital amount funded by LEH was \$3,659,340. For months in which GEL finances Deficit Amounts, LE does not receive any of its profit share until the Deficit Amounts have been repaid.

We believe that our aforementioned operational strategy will be sufficient to support our operations over the next 12 months. (See “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations – Operational Strategy” of this report for disclosures related to our operational strategy.) However, our efforts depend on several factors, including our future performance, levels of accounts receivable, inventories, accounts payable, capital expenditures, adequate access to credit and financial flexibility to attract long-term capital on satisfactory terms. These factors may be impacted by general economic, political, financial, competitive and other factors beyond our control. There can be no assurance that our operational strategy will achieve the anticipated outcomes, or that GEL and/or LEH will continue to fund our working capital requirements during months in which we have operational losses. In the event our operational strategy is not successful, or our working capital requirements are not funded by our profit share, GEL, or LEH, we may experience a significant and material adverse effect on our operations, liquidity, and financial condition. See “Part I, Item 1A. Risk Factors” in in this report for risk factors related to working capital, liquidity and Nixon Facility downtime.

For the Current Year, we experienced positive cash flow from operations of \$1,023,818. For the Prior Year, we experienced positive cash flow from operations of \$67,327. This represented an increase in cash flow from operations of \$956,491 for the Current Year compared to the Prior Year. For the three months ended December 31, 2013, we experienced positive cash flow from operations of \$5,584,365. For the three months ended December 31, 2012, we experienced positive cash flow from operations of \$3,112,606. This represented an increase in cash flow from operations of \$2,471,759 for the three months ended December 31, 2013 compared to the same period a year earlier.

We continue to work with our vendors to bring our outstanding accounts payable current as expeditiously as possible. In the event that our efforts are not successful, we will experience a significant and material adverse effect on our continuing operations, liquidity and financial condition.

Our U.S. Gulf of Mexico oil and gas properties were uneconomic for the years ended December 31, 2013 and 2012 as a result of leases being relinquished and fields being shut-in by operators. On February 28, 2013 Blue Dolphin Exploration Company (“BDEX”), a wholly owned subsidiary, completed the disposal of its 7% undivided working interest in the North Sumatra Basis – Langsa Field offshore Indonesia (“Indonesia”) pursuant to Sale and Purchase Agreement with Blue Sky Langsa Limited (“Blue Sky”) effective November 6, 2012.

We recognized \$63,767 of abandonment expense in the Current Year related to our High Island A-7 and High Island 37 oil and gas properties. For the Prior Year, plugging and abandonment costs related to our High Island A-7 oil and gas property exceeded the amount reserved for the ARO liability. Accordingly, the excess amount, which was \$1,184,549, was recognized as a loss in the Prior Year. We will record additional plugging and abandonment costs for oil and gas properties as information becomes available from operators to substantiate actual and/or probable costs.

Capital expenditures in the Current Year and Prior Year totaled \$1,477,729 and \$2,852,460, respectively, which related to investments in the Nixon Facility and \$592,415 of asset retirement obligations incurred in a non-cash transaction. Capital expenditures in the three month periods ended December 31, 2013 and 2012 totaled \$232,870 and \$284,011, respectively, which related to investments in the Nixon Facility. We expect to fund additional capital expenditures at the Nixon Facility primarily through the Construction and Funding Agreement, cash from operations or other borrowings. The principal balance owed to Milam under the Construction and Funding Agreement was \$5,747,330 and \$5,206,175, including Deficit Amounts, at December 31, 2013 and 2012, respectively.

The principal balance outstanding on the Refinery Note was \$9,057,937 and \$9,298,183 at December 31, 2013 and 2012, respectively. On June 1, 2013, AFNB and LE agreed to amend the Refinery Note (the "Note Modification Agreement"). Pursuant to the Note Modification Agreement, the monthly principal and interest payment due under the Refinery Note is \$75,310.

The principal balance outstanding on the Notre Dame Debt was \$1,300,000 at December 31, 2013 and 2012. There are no financial covenants associated with this debt.

See "Part II, Item 8. Financial Statements and Supplementary Data - Note (15) Long-Term Debt" of this report for additional disclosures related to our long-term debt obligations.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Commodity Price Risk. We are exposed to market price risk related to our refined petroleum products and crude oil inventory. The spread between crude oil and refined product prices is the primary factor affecting our operations, liquidity and financial condition. Our crude acquisition costs and refined petroleum products sales prices depend on numerous factors beyond our control. These factors include the supply of and demand for crude oil, gasoline, NRLM and other refined petroleum products. Supply and demand for these products depend, among other things, on changes in domestic and foreign economies; weather conditions; domestic and foreign political affairs; production levels; availability of imports and exports; marketing of competitive fuels; and government regulation.

In May 2012, we implemented an inventory risk management policy under which Genesis may, but is not required to, use derivative instruments as certain refined product inventories exceed maximum thresholds in an effort to reduce our refined petroleum products and crude oil inventory commodity price risk. However, Genesis' execution of the inventory risk management plan is outside of our control. Accordingly, there could be situations in which Genesis fails to execute on the plan or executes on the plan in a manner that causes significant losses to us, all of which are beyond our control. In the event that our inventory risk management system fails and/or is implemented poorly or not at all, we could experience a material and negative adverse effect on our operations, liquidity and financial condition.

At December 31, 2013, we performed a sensitivity analysis to determine the impact of an increase in the market price of commodity contracts for our economic hedges. Based on this sensitivity analysis, we determined that an increase of \$1.00 per barrel in commodity contracts held at December 31, 2013 would increase unrealized loss by approximately \$45,000.

Interest Rate Risk. We are exposed to interest rate volatility with regard to existing variable rate debt tied to movements in the U.S. prime rate. At December 31, 2013, we had \$9,057,937 of variable interest debt with a weighted average interest rate at year end of approximately 5.50%. At December 31, 2013, we performed a sensitivity analysis to determine the impact of an increase in interest rates. Based on this sensitivity analysis, we determined that an increase of 1% in our average floating interest rates at December 31, 2013 would increase interest expense by approximately \$90,579 per year.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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Report of Independent Registered Public Accounting Firm

The Board of Directors and
Stockholders of Blue Dolphin Energy Company

We have audited the accompanying consolidated balance sheets of Blue Dolphin Energy Company and its subsidiaries (the "Company") as of December 31, 2013 and 2012, 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 management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Blue Dolphin Energy Company and its subsidiaries as of December 31, 2013 and 2012, and the consolidated results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

/s/ UHY LLP
Sterling Heights, Michigan
March 31, 2014

Blue Dolphin Energy Company & Subsidiaries
Consolidated Balance Sheets

	December 31,	
	2013	2012
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$434,717	\$420,896
Restricted cash	327,388	89,593
Accounts receivable	13,487,106	15,398,755
Prepaid expenses and other current assets	333,683	228,314
Deposits	1,219,660	1,236,447
Inventory	4,686,399	2,300,692
Total current assets	20,488,953	19,674,697
Total property and equipment, net	36,388,666	35,862,085
Debt issue costs, net	498,536	532,335
Other assets	-	9,463
Trade name	303,346	303,346
TOTAL ASSETS	\$57,679,501	\$56,381,926
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	\$20,783,541	\$19,171,013
Accounts payable, related party	3,659,340	1,594,021
Notes payable	11,884	43,941
Asset retirement obligations, current portion	107,388	-
Accrued expenses and other current liabilities	1,600,444	725,238
Interest payable, current portion	40,272	640,352
Long-term debt, current portion	2,215,918	1,816,960
Total current liabilities	28,418,787	23,991,525
Long-term liabilities:		
Asset retirement obligations, net of current portion	1,490,273	921,260
Long-term debt, net of current portion	13,889,349	13,989,517
Long-term interest payable, net of current portion	1,767,381	858,784
Total long-term liabilities	17,147,003	15,769,561
TOTAL LIABILITIES	45,565,790	39,761,086
STOCKHOLDERS' EQUITY		
Common stock (\$0.01 par value, 20,000,000 shares authorized, 10,580,973 and 10,563,297 shares issued at December 31, 2013 and December 31, 2012, respectively)	105,810	105,633
Additional paid-in capital	36,623,965	36,524,142
Accumulated deficit	(23,816,064)	(20,008,935)
Treasury stock, 150,000 shares and 0 shares, respectively, at cost	(800,000)	-

Total stockholders' equity	12,113,711	16,620,840
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$57,679,501	\$56,381,926

See accompanying notes to consolidated financial statements.

Blue Dolphin Energy Company & Subsidiaries
Consolidated Statements of Operations

	Year Ended December 31,	
	2013	2012
REVENUE FROM OPERATIONS		
Refined product sales	\$409,239,747	\$351,665,234
Pipeline operations	303,122	406,812
Oil and gas sales	200	22,668
Total revenue from operations	409,543,069	352,094,714
COST OF OPERATIONS		
Cost of refined products sold	399,101,182	342,035,755
Refinery operating expenses	10,673,722	8,603,155
Pipeline operating expenses	163,163	391,169
Lease operating expenses	67,923	57,122
General and administrative expenses	1,794,053	2,076,946
Depletion, depreciation and amortization	1,342,563	1,622,864
Abandonment expense	63,767	1,184,549
Impairment expense	-	9,435,745
Bad debt expense	-	9,508
Accretion expense	112,686	105,032
Loss on disposal of property and equipment	-	5,665
Total cost of operations	413,319,059	365,527,510
Loss from operations	(3,775,990)	(13,432,796)
OTHER INCOME (EXPENSE)		
Net tank rental and easement revenue	1,155,064	534,047
Interest and other income	3,105	21,940
Interest expense	(1,100,053)	(954,579)
Total other income (expense)	58,116	(398,592)
Loss from continuing operations before income taxes	(3,717,874)	(13,831,388)
Income tax expense, current	(89,255)	(9,678)
Loss from continuing operations, net of tax	(3,807,129)	(13,841,066)
Loss from discontinued operations, net of tax	-	(4,443,566)
Net loss	\$(3,807,129)	\$(18,284,632)
Basic loss per common share		
Continuing operations	\$(0.36)	\$(1.35)
Discontinued operations	\$-	\$(0.43)

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Basic loss per common share	\$ (0.36)	\$ (1.78)
Diluted loss per common share		
Continuing operations	\$ (0.36)	\$ (1.35)
Discontinued operations	\$ -	\$ (0.43)
Diluted loss per common share	\$ (0.36)	\$ (1.78)
Weighted average number of common shares outstanding:		
Basic	10,445,883	10,284,152
Diluted	10,445,883	10,284,152

See accompanying notes to consolidated financial statements.

Blue Dolphin Energy Company & Subsidiaries
Consolidated Statements of Stockholders' Equity

	Common Stock			Accumulated Deficit	Treasury Stock		Total Stockholders' Equity
	Shares Issued	Par Value	Additional Paid-In Capital		Shares	Cost	
Balance at December 31, 2011	8,426,456	\$84,265	\$17,302,124	\$(1,724,303)	-	\$-	\$15,662,086
Common stock issued for acquisition	2,098,390	20,984	18,025,170	-	-	-	18,046,154
Conversion of LE's related party accounts payable to equity on acquisition	-	-	993,732	-	-	-	993,732
Common stock issued for services	30,288	303	183,197	-	-	-	183,500
Common stock issued to exercise options	8,163	81	19,919	-	-	-	20,000
Net loss	-	-	-	(18,284,632)	-	-	(18,284,632)
Balance at December 31, 2012	10,563,297	105,633	36,524,142	(20,008,935)	-	-	16,620,840
Common stock issued for services	17,676	177	99,823	-	-	-	100,000
Treasury stock acquired	-	-	-	-	(150,000)	(800,000)	(800,000)
Net loss	-	-	-	(3,807,129)	-	-	(3,807,129)
Balance at December 31, 2013	10,580,973	\$105,810	\$36,623,965	\$(23,816,064)	(150,000)	\$(800,000)	\$12,113,711

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Blue Dolphin Energy Company & Subsidiaries
Consolidated Statements of Cash Flows

	Years Ended December 31,	
	2013	2012
OPERATING ACTIVITIES		
Net loss	\$(3,807,129)	\$(18,284,632)
Loss from discontinued operations	-	4,443,566
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depletion, depreciation and amortization	1,342,563	1,611,708
Impairment of oil and gas properties	-	9,435,745
Unrealized loss (gain) on derivatives	(143,050)	136,100
Amortization of debt issue costs	33,800	33,799
Amortization of intangible assets	9,463	10,468
Accretion expense	112,686	105,032
Abandonment costs incurred	63,767	503,454
Common stock issued for services	100,000	163,499
Bad debt expense	-	9,508
Changes in operating assets and liabilities (net of effects of acquisition in 2012)		
Restricted cash	(237,795)	102,411
Accounts receivable	1,111,649	(14,724,996)
Prepaid expenses and other current assets	(105,369)	43,894
Deposits and other assets	16,787	(763,421)
Inventory	(2,385,707)	2,288,436
Accounts payable, accrued expenses and other liabilities	2,846,834	12,160,088
Accounts payable, related party	2,065,319	3,228,128
Net cash provided by operating activities - continuing operations	1,023,818	502,787
Net cash used in operating activities - discontinued operations	-	(435,460)
Net cash provided by operating activities	1,023,818	67,327
INVESTING ACTIVITIES		
Capital expenditures	(1,477,729)	(2,852,460)
Proceeds from sale of assets	201,000	-
Cash acquired on acquisition	-	1,674,709
Net cash used in investing activities	(1,276,729)	(1,177,751)
FINANCING ACTIVITIES		
Proceeds from issuance of debt	5,750,611	4,788,623
Payments on long-term debt	(5,274,106)	(3,276,748)
Proceeds from notes payable	15,032	24,548
Payments on notes payable	(224,805)	(26,925)
Proceeds from exercise of stock options	-	20,000
Net cash provided by financing activities	266,732	1,529,498
Net increase (decrease) in cash and cash equivalents	13,821	419,074
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	420,896	1,822

CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$434,717	\$420,896
Supplemental Information:		
Non-cash operating activities		
Reduction in accounts receivable in exchange for treasury stock received	\$800,000	\$-
Non-cash investing and financing activities:		
Changes in estimates of existing ARO obligations	\$592,415	\$-
Financing of insurance premiums	\$-	\$82,560
Related party payable converted to equity	\$-	\$993,732
Acquisition of Blue Dolphin at fair value, inclusive of cash acquired of \$1,674,594	\$-	\$18,046,154
Prior period accounts payable converted to common stock	\$-	\$20,001

See accompanying notes to consolidated financial statements.

Blue Dolphin Energy Company & Subsidiaries
Notes to Consolidated Financial Statements

(1) Organization

Nature of Operations

Blue Dolphin Energy Company (referred to herein, with its predecessors and subsidiaries, as “Blue Dolphin,” “we,” “us” and “our”) is a Delaware corporation that was formed in 1986 as a holding company. We are primarily an independent refiner and marketer of petroleum products. Our primary asset is a 56 acre crude oil and condensate processing facility, which is located in Nixon, Wilson County, Texas (the “Nixon Facility”). As part of our refining business segment we also conduct petroleum storage and terminaling operations. These operations involve the storage of petroleum under third-party lease agreements at the Nixon Facility. We also own and operate pipeline assets and have leasehold interests in oil and gas properties. See “Note (6) Business Segment Information” for further discussion of our business segments.

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

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

Operating Risks

We had cash and cash equivalents of \$434,717 and \$420,896 at December 31, 2013 and December 31, 2012, respectively, and have historically incurred recurring losses from operations. As of December 31, 2013, we were in violation of certain financial covenants in a loan agreement dated September 29, 2008 (the “Loan Agreement”) by and between LE and First International Bank (“FIB”) as evidenced by that certain promissory note, of even date with the Loan Agreement, in the original principal amount of \$10,000,000 (the “Refinery Note”). In October 2011, the Loan Agreement was acquired by American First National Bank (“AFNB”). We are currently making our scheduled payments in accordance with the terms and conditions of the Loan Agreement and, as of December 31, 2013, we obtained a waiver for certain financial covenants effective through December 31, 2014. See “Note (15) Long-Term Debt” of this report for additional disclosures related to the Refinery Note.

We currently rely on our profit share under the Joint Marketing Agreement by and between LE and GEL TEX Marketing, LLC (“GEL”), an affiliate of Genesis Energy, LLC (“Genesis”), dated August 12, 2011 (the “Joint Marketing Agreement”), and Lazarus Energy Holdings, LLC (“LEH”) to fund our working capital requirements. GEL is also the exclusive supplier of our crude oil for the Nixon Facility under the Crude Oil and Supply Throughput Services Agreement by and between LE and GEL dated August 12, 2011 (the “Crude Supply Agreement”). During months in which we receive no profit share under the Joint Marketing Agreement, GEL and/or LEH may, but are not required to, fund our working capital requirements. There can be no assurances that GEL and/or LEH will continue to fund our

working capital requirements. In the event our working capital requirements are not funded by our profit share, GEL and/or LEH, we may experience a significant and material adverse effect on our operations.

We believe that our operational strategy, including our recent introduction and production of jet fuel and the continued refurbishment of the naphtha stabilizer and depropanizer units at the Nixon Facility, will be sufficient to support our operations over the next twelve months. However, our efforts depend on several factors, including our future performance, levels of accounts receivable, inventories, accounts payable, capital expenditures, adequate access to credit, and financial flexibility to attract long-term capital on satisfactory terms. These factors may be impacted by general economic, political, financial, competitive and other factors that are beyond our control. There can be no assurance that our operational strategy will achieve the anticipated outcomes. In the event our operational strategy is not successful, or our working capital requirements are not funded by our profit share under the Joint Marketing Agreement, GEL, or LEH, we may experience a significant and material adverse effect on our operations, liquidity, and financial condition.

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

(2) Basis of Presentation

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

Operations associated with the North Sumatra Basin – Langsa Field offshore Indonesia (“Indonesia”), which were previously reported as part of our Oil and Gas Exploration & Production business segment, have been presented as discontinued operations in the consolidated financial statements. See “Note (22) Discontinued Operations” for additional information regarding these discontinued operations. Unless stated otherwise, any reference to income statement items in these financial statements refers to results from continuing operations.

(3) Significant Accounting Policies

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

Use of Estimates

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

Cash and Cash Equivalents

Cash equivalents include liquid investments with an original maturity of three months or less. Cash balances are maintained in depository and overnight investment accounts with financial institutions that, at times, exceed insured limits. We monitor the financial condition of the financial institutions and have experienced no losses associated with these accounts. Cash and cash equivalents amounted to \$434,717 and \$420,896 at December 31, 2013 and December 31, 2012, respectively.

Restricted Cash

Restricted cash was \$327,388 and \$89,593 at December 31, 2013 and December 31, 2012, respectively. These amounts primarily relate to a payment reserve account required under the Refinery Note.

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

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

Concentration of Risk

Financial instruments that potentially subject us to concentrations of credit risk consist primarily of cash, trade receivables and payables. We maintain our cash balances at banks located in Houston, Texas. Accounts in the United States are insured by the Federal Deposit Insurance Corporation up to \$250,000. We had uninsured balances of \$77,388 and \$170,896 at December 31, 2013 and December 31, 2012, respectively.

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

For the year ended December 31, 2013, we had 5 customers that accounted for approximately 92% of our refined petroleum product sales. These 5 customers represented approximately \$13.4 million in accounts receivable at December 31, 2013. For the year ended December 31, 2012, we had 4 customers that accounted for approximately 84% of our refined petroleum product sales. These 4 customers represented approximately \$11.4 million in accounts receivable at December 31, 2012.

Inventory

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

Price-Risk Management Activities

We utilize an inventory risk management policy under which Genesis may, but is not required to, use derivative instruments as economic hedges to reduce refined petroleum products and crude oil inventory commodity price risk. We follow FASB ASC guidance for derivatives and hedging related to stand-alone derivative instruments. These contracts are not subject to hedge accounting treatment under FASB ASC guidance. Although such hedge positions are direct contractual obligations of Genesis and not us, we record the fair value of these Genesis hedges in our consolidated balance sheet each financial reporting period because of contractual arrangements with Genesis under which we are effectively exposed to the potential gains or losses. Changes in the fair value from financial reporting period to financial reporting period are recognized in our consolidated statement of operations.

Property and Equipment

Refinery and Facilities. Additions to refinery and facilities are capitalized. Expenditures for repairs and maintenance, including maintenance turnarounds, are included in the Management Agreement and covered by LEH (see "Note (11) Accounts Payable Related Party" in this report for additional disclosures related to the Management Agreement). Management expects to continue making improvements to the Nixon Facility based on technological advances.

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

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

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

ended December 31, 2013 and 2012.

Oil and Gas Properties. We account for our oil and gas properties using the full-cost method of accounting, whereby all costs associated with acquisition, exploration and development of oil and gas properties, including directly related internal costs, are capitalized on a cost center basis. Amortization of such costs and estimated future development costs are determined using the unit-of-production method. Our U.S. Gulf of Mexico oil and gas properties were uneconomical for the years ended December 31, 2013 and 2012 due to leases being relinquished and fields being shut-in by operators. We disposed of our operations in Indonesia in 2012.

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

Construction in Progress. Construction in progress expenditures related to refurbishment activities at the Nixon Facility are capitalized as incurred. Depreciation begins once the asset is placed in service.

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

Intangibles – Goodwill and Other

Goodwill. We recognized goodwill in connection with our reverse merger in 2012 with LE. Goodwill has an indefinite useful life and represents the difference between the total purchase price and the fair value of assets (tangible and intangible) and liabilities at the date of acquisition and is reviewed for impairment annually, and more frequently as circumstances warrant, and written down only in the period in which the recorded value of such assets exceed their fair value. We do not amortize goodwill in accordance with FASB ASC guidance related to intangibles, goodwill and other. We perform an impairment test annually in the fourth quarter.

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

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

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

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

Other Intangible Assets. We recognized trade name in connection with our reverse merger with LE in 2012. We have determined our trade name to have an indefinite useful life. We account for other intangible assets under FASB ASC guidance related to intangibles, goodwill and other. Under the guidance, intangible assets with indefinite lives are tested annually for impairment. Management performed its regular annual impairment testing of trade name following FASB ASC guidance for determining impairment. Upon completion of that testing, we determined that no impairment was necessary as of December 31, 2013.

Debt Issue Costs

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

Debt issue costs, net of accumulated amortization, totaled \$498,536 and \$532,335 at December 31, 2013 and 2012, respectively. Accumulated amortization was \$177,445 and \$143,645 at December 31, 2013 and 2012, respectively. For the years ended December 31, 2013 and 2012, amortization expense, which is included in interest expense, was \$33,799 and \$8,450 respectively. See “Note (12) Notes Payable” and “Note (15) Long-Term Debt” of this report for additional disclosures related to the Refinery Note.

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

Revenue Recognition

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

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

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

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

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

Income Taxes

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

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

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income prior to the expiration of any net operating loss carryforwards. See "Note (21) Income Taxes" for further details.

Impairment or Disposal of Long-Lived Assets

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

Asset Retirement Obligations

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

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

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

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

Derivatives

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

Computation of Earnings Per Share

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

The number of shares related to options, warrants, restricted stock and similar instruments included in diluted EPS is based on the “Treasury Stock Method” prescribed in FASB ASC guidance for computation of EPS. This method assumes theoretical repurchase of shares using proceeds of the respective stock option or warrant exercised, and for

restricted stock the amount of compensation cost attributed to future services which has not yet been recognized and the amount of current and deferred tax benefit, if any, that would be credited to additional paid-in-capital upon the vesting of the restricted stock, at a price equal to the issuer's average stock price during the related earnings period. Accordingly, the number of shares includable in the calculation of EPS in respect of the stock options, warrants, restricted stock and similar instruments is dependent on this average stock price and will increase as the average stock price increases.

Stock-Based Compensation

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

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

Treasury Stock

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

Business Combinations

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

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

Reclassification

Certain reclassifications have been made to the prior year's consolidated financial statements in order to conform to the current year's presentation.

New Pronouncements Issued but Not Yet Effective

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

(4) LE Acquisition

Effective February 15, 2012, Blue Dolphin acquired 100% of the issued and outstanding membership interests of LE from LEH (the "LE Acquisition"). LE owns the Nixon Facility. The LE Acquisition was considered a business combination. As consideration for LE, Blue Dolphin issued, in reliance on the exemption provided by Section 4(2) of the Securities Act of 1933, as amended (the "Securities Act"), 8,393,560 shares of common stock, par value \$0.01 per share (the "Common Stock"), subject to anti-dilution adjustments, to LEH (the "Original BDEC Shares"). Additionally, on February 21, 2012, pursuant to anti-dilution provisions, Blue Dolphin issued, in reliance on the exemption provided by Section 4(2) of the Securities Act, 32,896 shares of Common Stock to LEH (the "Anti-Dilution Shares" and together with the Original BDEC Shares, the "BDEC Shares"). As a result of Blue Dolphin's issuance of the BDEC Shares, LEH owns approximately 81% of Blue Dolphin's issued and outstanding Common Stock. The issuance of the BDEC Shares

to LEH resulted in a change in control of Blue Dolphin. Jonathan Carroll, Chief Executive Officer and President of Blue Dolphin, is the majority owner of LEH.

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

The value assigned to the purchase price was allocated to Blue Dolphin's tangible and intangible assets and liabilities based on their fair values on the transaction closing date. LE's purchase price to acquire Blue Dolphin was based on the fair value of Blue Dolphin's issued and outstanding common stock at February 15, 2012, which was 2,098,390 shares, multiplied by Blue Dolphin's closing stock price of \$8.60 on February 15, 2012, the transaction closing date. This resulted in a fair value assessment of Blue Dolphin of \$18,046,154.

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

(5) LRM Acquisition

Effective October 1, 2012, we acquired 100% of the issued and outstanding membership interest of LRM, a wholly-owned subsidiary of LEH, pursuant to an Assignment Agreement. The acquisition was accounted for as a combination of entities under common control. Accordingly, the recognized assets and liabilities of LRM were transferred at their carrying amounts at the date of transfer and the results of operations are included for the years ended December 31, 2013 and 2012. Assets and liabilities included in the consolidated balance sheets were \$1,414,155 and \$66,600, respectively, as of December 31, 2013, and \$100,285 and \$499,591, respectively, as of December 31, 2012. LRM markets petroleum storage and terminaling services at the Nixon Facility.

(6) Business Segment Information

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

Segment financials for the year ended December 31, 2013 (and at December 31, 2013) were as follows:

	Year Ended December 31, 2013				Total
	Segment				
	Refinery Operations	Pipeline Transportation	Oil and Gas Exploration & Production	Corporate and Other	
Revenue	\$409,239,747	\$ 303,122	\$200	\$-	\$409,543,069
Operation cost(1)	(409,800,285)	(377,245)	(146,806)	(1,652,160)	(411,976,496)
Other non-interest income	1,113,397	41,667	-	-	1,155,064
EBITDA	\$552,859	\$ (32,456)	\$(146,606)	\$(1,652,160)	
Depletion, depreciation and amortization					(1,342,563)
Other expense, net					(1,096,948)
Loss from continuing operations, before income taxes					\$(3,717,874)
Capital expenditures	\$1,477,729	\$ -	\$-	\$-	\$1,477,729
Identifiable assets(2)	\$54,470,723	\$ 2,378,806	\$20,661	\$809,311	\$57,679,501

- (1) Within operation cost, general and administrative expenses are allocated across business segments based on revenue. General and administrative expenses associated with corporate maintenance costs (such as director fees and legal expenses) are included in the Corporate and Other business segment. The effect of economic hedges on our refined petroleum products and crude oil inventory, which are executed by Genesis, is included within the operation cost of our Refinery Operations business segment. Cost of refined products sold includes a realized loss of \$246,210 and an unrealized gain of \$143,050.
- (2) Identifiable assets contain related legal obligations of each business segment including cash, accounts receivable and recorded net assets.

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

Segment financials for the year ended December 31, 2012 (and at December 31, 2012) were as follows:

	Year Ended December 31, 2012				Total
	Segment				
	Refinery Operations	Pipeline Transportation	Oil and Gas & Exploration Production	Corporate and Other	
Revenue	\$351,665,234	\$ 406,812	\$22,668	\$-	\$352,094,714
Operation cost(1)	(350,940,269)	(8,676,242)	(2,018,126)	(2,270,009)	(363,904,646)
Other non-interest income	534,047	-	-	-	534,047
EBITDA	\$1,259,012	\$ (8,269,430)	\$(1,995,458)	\$(2,270,009)	
Depletion, depreciation and amortization					(1,622,864)
Other expense, net					(932,639)
Loss from continuing operations, before income taxes					\$(13,831,388)
Loss from discontinued operations					\$(4,443,566)
Capital expenditures	\$2,852,460	\$ -	\$-	\$-	\$2,852,460
Identifiable assets(2)	\$52,745,767	\$ 1,861,055	\$48,247	\$1,726,857	\$56,381,926

(1) Within operation cost, general and administrative expenses are allocated across business segments based on revenue. General and administrative expenses associated with corporate maintenance costs (such as director fees and legal expenses) are included in the Corporate and Other business segment. The effect of economic hedges on our refined petroleum products and crude oil inventory, which are executed by Genesis, is included within the operation cost of our Refinery Operations business segment. Cost of refined products sold includes a realized loss of \$90,507 and an unrealized loss of \$136,100. Impairment expenses of \$7,990,025 related to our pipeline fixed assets and \$1,445,720 related to goodwill are included within the operation cost of our Pipeline Transportation and Corporate and Other business segments, respectively.

Identifiable assets contain related legal obligations of each business segment including cash, accounts receivable (2) and payable and recorded net assets.

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

(7) Prepaid Expenses and Other Current Assets

Prepaid balances consisted of the following:

	December 31,	
	2013	2012
Prepaid insurance	\$165,004	\$185,814
Prepaid professional fees	104,000	-
Employee advances	-	22,500
Prepaid loan closing fees	33,513	20,000
Prepaid listing fees	15,000	-
Prepaid taxes	9,216	-
Unrealized hedging gains	6,950	-
	\$333,683	\$228,314

(8) Deposits

Deposit balances consisted of the following:

	December 31,	
	2013	2012
Utility deposits	\$10,250	\$36,500
Equipment deposits	124,526	124,526
Tax bonds	792,000	792,000
Purchase option deposits	283,421	283,421
Rent deposits	9,463	-
	\$1,219,660	\$1,236,447

(9) Inventories

Inventory balances consisted of the following:

	December 31,	
	2013	2012
Low-sulfur diesel	\$1,813,662	\$397,240
Naphtha	804,490	1,562,055
Atmospheric gas oil	575,919	322,356
Jet fuel	1,444,399	-
LPG mix	28,888	-

Crude	19,041	19,041
	\$4,686,399	\$2,300,692

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

(10) Property, Plant and Equipment, Net

Property and equipment consisted of the following:

	December 31,	
	2013	2012
Refinery and facilities	\$35,852,928	\$34,000,199
Pipelines and facilities	1,826,226	1,233,811
Onshore separation and handling facilities	325,435	325,435
Land	577,965	577,965
Other property and equipment	567,813	577,567
	39,150,367	36,714,977
Less: Accumulated depletion, depreciation and amortization	3,016,713	1,674,151
	36,133,654	35,040,826
Construction in Progress	255,012	821,259
Property, Plant and Equipment, Net	\$36,388,666	\$35,862,085

(11) Accounts Payable, Related Party

LEH, which owns approximately 81% of our outstanding common stock, par value \$0.01 per share (the “Common Stock”), manages all of our subsidiaries and operates all of our assets, including the Nixon Facility, (the “Services”) pursuant to a Management Agreement dated February 15, 2012 (the “Management Agreement”). Jonathan Carroll, Chief Executive Officer and President of Blue Dolphin, is the majority owner of LEH.

With respect to the Nixon Facility, the Management Agreement represents, in effect, an operating agreement that covers all refinery operating expenses with the exception of capital expenditures. Pursuant to the Management Agreement, for management and operation of the Nixon Facility, LEH has the right to receive: (i) weekly payments not to exceed \$750,000 per month, (ii) reimbursement for certain accounting costs related to the preparation of financial statements of LE not to exceed \$50,000 per month, (iii) \$0.25 for each barrel processed at the Nixon Facility during the term of the Management Agreement, up to a maximum quantity of 10,000 barrels per day determined on a monthly basis, and (iv) \$2.50 for each barrel in excess of 10,000 barrels per day processed at the Nixon Facility during the term of the Management Agreement, determined on a monthly basis. LEH is also reimbursed at cost for all reasonable expenses incurred while performing the Services.

All compensation owed to LEH under the Management Agreement is to be paid to LEH within 30 days of the end of each calendar month. The Management Agreement expires upon the earliest to occur of: (a) the date of the termination of the Joint Marketing Agreement, which has an initial term of three years and successive one-year renewals until August 12, 2019 unless sooner terminated by GEL with 180 days prior written notice, (b) August 12, 2014, or (c) upon written notice of either party to the Management Agreement of a material breach of the Management Agreement

by the other party. If the Management Agreement is renewed after the expiration of its initial term, then it will thereafter be reviewed on an annual basis by our Board of Directors (the "Board") and it may be terminated if the Board determines that the Management Agreement is no longer in our best interests.

Aggregate amounts expensed for Services at the Nixon Facility and to fund working capital deficits not funded by Genesis for the years ended December 31, 2013 and 2012 were \$10,673,722 (approximately \$2.79 per barrel of throughput) and \$8,603,155 (approximately \$2.71 per barrel of throughput). At December 31, 2013 and 2012, the amounts outstanding to LEH were \$3,659,340 and \$1,594,021, respectively, and are reflected in accounts payable, related party in the consolidated balance sheets.

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

(12) Notes Payable

Our notes payable consists of a short-term note for financing services and short-term capital leases, as follows:

	December 31,	
	2013	2012
Short-Term Note for Financing Costs	\$9,379	\$39,866
Short-Term Capital Leases	2,505	4,075
	\$11,884	\$43,941

Short-Term Note for Financing Services. The balance on a short-term note issued in January 2010 in the amount of \$100,000 as payment for financing services was \$9,379 and \$39,866 at December 31, 2013 and 2012, respectively. The unsecured note, which bears interest at a base rate of 10% and a default rate of 18%, was originally due in January 2012. The due date was extended to March 2014.

Short-Term Capital Leases. The balance on short-term notes under capital lease agreements was \$2,505 and \$4,075 at December 31, 2013 and 2012, respectively. Capital leases totaling \$1,250, which were classified as long-term debt at December 31, 2012, were re-classified to short-term debt at December 31, 2013 as they mature at various dates through February 2014. These capital leases have interest rates ranging from 0% to 13.04%. The assets and liabilities under capital leases are recorded at the lower of the present value of the minimum lease payments or the fair value of the assets. The assets are amortized over the lower of their related lease terms or their estimated productive lives.

(13) Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities consisted of the following:

	December 31,	
	2013	2012
Taxes payable	\$688,754	\$292,303
Transportation	100,000	69,551
Unrealized hedging loss	-	136,100
Unearned revenue	302,505	92,783
Other payable	509,185	134,501
	\$1,600,444	\$725,238

(14) Asset Retirement Obligations

Refinery and Facilities

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

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

Pipelines and Facilities Assets and Oil and Gas Properties

We have AROs associated with the dismantlement and abandonment in place of our pipelines and facilities assets, as well as the plugging and abandonment of our oil and gas properties. We recorded a discounted liability for the fair value an ARO with a corresponding increase to the carrying value of the related long-lived asset at the time the asset was installed or placed in service. We amortize the amount added to property and equipment and recognize accretion expense in connection with the discounted liability over the remaining life of the asset. Effective December 31, 2013, we updated our estimates in computing the estimated ARO for the abandonment in place of our pipelines and an associated platform. A change in the retirement date of these assets resulted in an increase in ARO of \$592,415 for the year ended December 31, 2013.

The following provides a roll-forward of our AROs:

Fair value of asset retirement obligations at February 15, 2012	\$ 1,294,139
Liabilities extinguished	(361,680)
Liabilities settled	(141,099)
Accretion expense from continuing operations	105,032
Accretion expense from discontinued operations	24,868
	921,260
Less: current portion of asset retirement obligations	-
Asset retirement obligations, long-term balance at December 31, 2012	\$921,260
Asset retirement obligations at December 31, 2012	\$921,260
Changes in estimates of existing obligations	592,415
Liabilities settled	(28,700)
Accretion expense	112,686
	1,597,661
Less: current portion of asset retirement obligations	107,388
Asset retirement obligations, long-term balance at December 31, 2013	\$ 1,490,273

For the year ended December 31, 2013, we recognized \$63,767 in abandonment expense related to our High Island A-7 and High Island 37 oil and gas properties. For the year ended December 31, 2012, plugging and abandonment costs related to our High Island A-7 oil and gas property exceeded the amount reserved for the ARO liability. Accordingly, the excess amount, which was \$1,184,549, was recognized as a loss during the period. We will record additional plugging and abandonment costs for oil and gas properties as information becomes available from operators to substantiate actual and/or probable costs.

(15) Long-Term Debt

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

	December 31,	
	2013	2012
Refinery Note	\$9,057,937	\$9,298,183
Notre Dame Debt	1,300,000	1,300,000
Construction and Funding Agreement	5,747,330	5,206,175
Capital Leases	-	2,119
	16,105,267	15,806,477
Less: Current portion of long-term debt	2,215,918	1,816,960
	\$13,889,349	\$13,989,517

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

The following is a schedule of future long-term debt payments:

Years Ending December 31,	Future Long-Term Debt Payments
2014	2,215,918
2015	3,539,379
2016	2,264,164
2017	837,676
2018	518,006
Subsequent to 2018	6,730,124
	\$16,105,267

Refinery Note. The Refinery Note accrues interest at a rate of prime plus 2.25% (effective rate of 5.50% at December 31, 2013) and has a maturity date of October 1, 2028 (the “Maturity Date”). LE’s obligations under the Refinery Note are secured by a Deed of Trust (the “Deed of Trust”) of even date with the Loan Agreement. The Refinery Note is further secured by a Security Agreement (the “Security Agreement” and, together with the Loan Agreement, the Refinery Note and Deed of Trust, the “Refinery Loan Documents”) also of even date with the Refinery Note, which Security Agreement covers various items of collateral including a first lien on the Nixon Facility and general assets of LE. The principal balance outstanding on the Refinery Note was \$9,057,937 and \$9,298,183 at December 31, 2013 and 2012, respectively. Interest was accrued on the Refinery Note in the amount of \$40,132 and \$250,070 at December 31, 2013 and December 31, 2012, respectively. See “Note (1) Organization – Operating Risks” of this report for additional disclosures related to the Refinery Note.

The Loan Agreement has two financial covenants relating to a current ratio and debt-to-worth. As of December 31, 2013, we were in violation of the current ratio covenant. However, as of December 31, 2013, we obtained a waiver related to the financial covenants effective through December 31, 2014.

In October 2011, the Refinery Loan Documents were acquired by AFNB. On June 1, 2013, AFNB and LE amended the Refinery Note (the “Note Modification Agreement”). Pursuant to the Note Modification Agreement, the monthly principal and interest payment due under the Refinery Note is \$75,310. Other than modification of the payment terms under the Refinery Note, the terms under the Loan Agreement and the Refinery Note remain the same through the Maturity Date and the Refinery Loan Documents remain in full force and effect.

Construction and Funding Agreement. In August 2011, Milam committed funding for the completion of the Nixon Facility’s refurbishment and start-up operations. Payments under the Construction and Funding Agreement began in the first quarter of 2012. All amounts advanced under the Construction and Funding Agreement bear interest at a rate of 6% annually. The principal balance outstanding on the Construction and Funding Agreement was \$5,747,330 and \$5,206,175 at December 31, 2013 and 2012, respectively. Interest was accrued on the Construction and Funding Agreement in the amount of \$700,597 and \$386,695 at December 31, 2013 and 2012, respectively. There are no financial covenants associated with this obligation.

See “Note (26) Commitments and Contingencies” of this report for additional disclosures related to amendments and/or modifications to the Crude Supply Agreement, Construction and Funding Agreement and Joint Marketing Agreement.

Notre Dame Debt. LE entered into a loan with Notre Dame Investors, Inc. as evidenced by that certain promissory note in the original principal amount of \$8,000,000, which is currently held by John Kissick (the “Notre Dame Debt”). The Notre Dame Debt accrues interest at a rate of 16% and is secured by a Deed of Trust, Security Agreement and Financing Statements (the “Subordinated Deed of Trust”), which encumbers the Nixon Facility and general assets of LE. The principal balance outstanding on the Notre Dame Debt was \$1,300,000 at December 31, 2013 and 2012. Interest was accrued on the Notre Dame Debt in the amount of \$1,066,784 and \$858,784 at December 31, 2013 and 2012, respectively. There are no financial covenants associated with the Notre Dame Debt.

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

Pursuant to an Intercreditor and Subordination Agreement dated September 29, 2008, the holder of the Notre Dame Debt and Subordinated Deed of Trust agreed to subordinate its interest and liens on the Nixon Facility and general assets of LE in favor of the holder of the Refinery Note, the Deed of Trust and Security Agreement.

Pursuant to an Intercreditor and Subordination Agreement dated August 12, 2011, the holder of the Notre Dame Debt and Subordinated Deed of Trust agreed to subordinate its interest and liens on the Nixon Facility and general assets of LE in favor of Milam under the Construction and Funding Agreement.

Pursuant to a First Amendment to Promissory Note made effective July 1, 2013, the Notre Dame Debt was amended as follows: (i) the annual interest rate on the unpaid balance was set to 16% and the final maturity became July 1, 2015.

Capital Leases. Capital lease obligations previously classified as long-term debt were reclassified to short-term notes payable in 2013 as they mature in February 2014. Long-term capital lease obligations totaled \$0 and \$2,119 at December 31, 2013 and 2012.

(16) Stock Options

The Plan, which has historically offered incentive awards to employees, including officers (whether or not they are directors), consultants and non-employee directors, was initially established by the Board on April 14, 2000 and approved by Blue Dolphin's stockholders on May 18, 2000. The Plan was amended effective March 19, 2003 and ratified by Blue Dolphin's stockholders on May 21, 2003 to increase the common stock available for issuance under the Plan from 500,000 shares to 650,000 shares (Amendment No. 1). The Plan was further amended effective April 5, 2007 and ratified by Blue Dolphin's stockholders effective May 30, 2007 to increase the common stock available for issuance under the Plan from 650,000 shares to 1,200,000 shares (Amendment No. 2). Effective July 16, 2010, Blue Dolphin's stockholders approved a 1-for-7 reverse-stock-split of its common stock, which reduced the number of shares of common stock available for issuance under the Plan from 1,200,000 shares to 171,128 shares (Amendment No. 3). Effective January 27, 2012, Blue Dolphin's stockholders approved an amendment to the Plan to change the expiration date of the Plan from 10 to 20 years (to April 14, 2020), as well as increase the aggregate number of common stock available for issuance under the Plan from 171,128 shares to 1,000,000 shares (Amendment No. 4). Although the Compensation Committee of the Board approved continuation of the Plan following Blue Dolphin's reverse merger with LE, pursuant to the Management Agreement, all employees of Blue Dolphin became employees of LEH effective February 15, 2012. As a result, with the exception of options outstanding for Ivar Siem, options outstanding for Blue Dolphin employees were cancelled ninety (90) days following the effective date of the Management Agreement. There were no stock options granted under the Plan in the years ended December 31, 2013 and 2012.

At December 31, 2013, there were a total of 0 shares of common stock reserved for issuance upon exercise of outstanding options under the Plan. A summary of the status of stock options granted to key employees, officers and directors, for the purchase of shares of common stock for the periods indicated, is as follows:

Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual	Aggregate Intrinsic Value
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Life (Years)

Options outstanding at December 31, 2012	14,642	\$ 19.67	0.9	-
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