BLUE DOLPHIN ENERGY CO
Form 10-Q
August 14, 2018

BLUE DOLPHIN ENERGY COMPANY FORM 10-Q 6/30/18

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
–
FORM 10-Q
(Mark One)
QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2018
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	73-1268729
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
801 Travis Street, Suite 2100, Houston, Texas	77002
(Address of principal executive offices)	(Zip Code)

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

Indicate by check mark whether the registrant (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

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

Large accelerated filer		Accelerated filer
Non-accelerated filer	(Do not check if a smaller reporting company)	Smaller reporting company
		Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Number of shares of common stock, par value $0.01 per share outstanding as of August 14, 2018: 10,925,513

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INTRODUCTION

This Quarterly Report for the quarterly period ended June 30, 2018 (this "Quarterly Report") is a document that U.S. public companies file with the Securities and Exchange Commission ("SEC") each quarter. Part I, Item 1. of the Quarterly Report contains financial information, including consolidated financial statements and related notes. Part I, Item 2. of this Quarterly Report provides management's discussion and analysis of our financial condition and results of operations. We hope investors will find it useful to have this information in a single document.

In this Quarterly Report, "Blue Dolphin," "we," "our," and "us" are used interchangeably to refer to Blue Dolphin Energy Company individually or to Blue Dolphin Energy Company and its subsidiaries collectively, as appropriate to the context. Information in this Quarterly Report is current as of the filing date, unless otherwise specified.

CAUTION REGARDING FORWARD-LOOKING STATEMENTS

In this Quarterly Report, and from time to time throughout the year, we share our expectations for our future performance. These forward-looking statements include statements about our business plans; our expected financial performance, including the anticipated effect of strategic actions; previously reported material weakness in our internal control over financial reporting; economic, political and market conditions; and other factors that could affect our future results of operations or financial condition, including, without limitation, statements under the section entitled "Part I, Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations," "Part II, Item 1. Legal Proceedings," and "Part II, Item 1A. Risk Factors." Any statements we make that are not matters of current reportage or historical fact should be considered forward-looking. Such statements often include words such as "believe," "expect," "anticipate," "intend," "plan," "estimate," "will," and similar expressions. By their nature, these types of statements are uncertain and are not guarantees of our future performance. Our forward-looking statements represent our estimates and expectations at the time of disclosure. However, circumstances change constantly, often unpredictably, and investors should not place undue reliance on these statements. Many events beyond our control will determine whether our expectations will be realized. We disclaim any current intention or obligation to revise or update any forward-looking statements, or the factors that may affect their realization, whether considering new information, future events or otherwise, and investors should not rely on us to do so.

In accordance with the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995, "Part I, Item 1A. Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017 (the "Annual Report"), "Part II, Item 1A. Risk Factors" in our Quarterly Report on Form 10-Q for the period ended March 31, 2018, and "Part II, Item 1A. Risk Factors" in this Quarterly Report explain some of the important factors that may cause actual results to be materially different from those that we anticipate.

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GLOSSARY OF SELECTED ENERGY AND FINANCIAL TERMS

Below are abbreviations and definitions of certain commonly used oil and gas industry terms, as well as key financial performance measures used by management, that are used in this Quarterly Report.

Regarding financial terms, management uses U.S. generally accepted accounting principles ("GAAP") and certain non-GAAP performance measures to assess our results of operations. Certain performance measures used by management to assess our operating results and the effectiveness of our business segment are considered non-GAAP performance measures. These performance measures may differ from similar calculations used by other companies within the petroleum industry, thereby limiting their usefulness as a comparative measure. We refer to certain refinery throughput and production data in the explanation of our period over period changes in results of operations. For our consolidated results, we refer to our consolidated statements of operations in the explanation of our period over period changes in results of operations.

Energy Terms

Atmospheric gas oil ("AGO"). The heaviest product boiled by a crude distillation tower operating at atmospheric pressure. This fraction ordinarily sells as distillate fuel oil, either in pure form or blended with cracked stocks. Certain ethylene plants, called heavy oil crackers, can take AGO as feedstock.

Barrel ("bbl"). A unit of volume equal to 42 U.S. gallons.

Barrels per Day ("bpd"). A measure of the bbls of daily output produced in a refinery or transported through a pipeline.

Complexity. A numerical score that denotes, for a given refinery, the extent, capability, and capital intensity of the refining processes downstream of the crude distillation tower. Refinery complexities range from the relatively simple crude distillation tower ("topping unit"), which has a complexity of 1.0, to the more complex deep conversion ("coking") refineries, which have a complexity of 12.0.

Condensate. Liquid hydrocarbons that are produced in conjunction with natural gas. Although condensate is sometimes like crude oil, it is usually lighter.

Crude distillation tower. A tall column-like vessel in which crude oil and condensate is heated and its vaporized components are distilled by means of distillation trays. This process turns crude oil and other inputs into intermediate and finished petroleum products. (Commonly referred to as a crude distillation unit or an atmospheric distillation unit.)

Crude oil. A mixture of thousands of chemicals and compounds, primarily hydrocarbons. Crude oil quality is measured in terms of density (light to heavy) and sulfur content (sweet to sour). 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.

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

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 (such as naphtha), (ii) light oils or middle distillates (such as our jet fuel), (iii) medium oils, and (iv) heavy oils (such as our low-sulfur diesel and heavy oil-based mud blendstock ("HOBM"), reduced crude, and AGO).

Distillation. The first step in the refining process whereby crude oil and condensate is heated at atmospheric pressure in the base of a distillation tower. As the temperature increases, the various compounds vaporize in succession at their various boiling points and then rise to prescribed levels within the tower per 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.

Feedstocks. Crude oil and other hydrocarbons, such as condensate and/or intermediate products, that are used as basic input materials in a refining process. Feedstocks are transformed into one or more finished products.

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.

Intermediate petroleum products. A petroleum 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 petroleum 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.

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

Light crude. A liquid petroleum that has a low density and flows freely at room temperature. It has a low viscosity, low specific gravity, and a high American Petroleum Institute gravity due to the presence of a high proportion of light hydrocarbon fractions.

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

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.

Product Slate. Represents type and quality of products produced.

Propane. A by-product of natural gas processing and petroleum refining. Propane is one of a group of liquified petroleum gases. Others include butane, propylene, butadiene, butylene, isobutylene and mixtures thereof.

Refined petroleum products. Refined petroleum products are derived from crude oil and condensate 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.

Refinery. Within the oil and gas industry, a refinery is an industrial processing plant where crude oil and condensate is separated and transformed into petroleum products.

Sour crude. Crude oil containing sulfur content of more than 0.5%.

Stabilizer unit. 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%.

Sulfur. Present at various levels of concentration in many hydrocarbon deposits, such as petroleum, coal, or natural gas. Also, produced as a by-product of removing sulfur-containing contaminants from natural gas and petroleum. Some of the most commonly used hydrocarbon deposits are categorized per 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. A type of petroleum refinery that engages in only the first step of the refining process -- crude distillation. A topping unit uses atmospheric distillation to separate crude oil and condensate into constituent petroleum products. A topping unit has a refinery complexity range of 1.0 to 2.0.

Throughput. The volume processed through a unit or a refinery or transported through a pipeline.

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

Yield. The percentage of refined petroleum products that is produced from crude oil and other feedstocks.

Financial and Performance Measures

Capacity Utilization Rate. A percentage measure that indicates the amount of available capacity that is being used in a refinery or transported through a pipeline. With respect to the crude distillation tower, the rate is calculated by dividing total refinery throughput or total refinery production on a bpd basis by the total capacity of the crude distillation tower (currently 15,000 bpd).

Cost of Refined Products Sold. Primarily includes purchased crude oil and condensate costs, as well as transportation, freight and storage costs.

Depletion, Depreciation and Amortization. Represents property and equipment, as well as intangible assets that are depreciated or amortized based on the straight-line method over the estimated useful life of the related asset.

Downtime. Scheduled and/or unscheduled periods in which the crude distillation tower is not operating. Downtime may occur for a variety of reasons, including bad weather, power failures, and preventive maintenance.

Easement, Interest and Other Income. Reflects land easement fees received from FLNG Land II, Inc., a Delaware corporation ("FLNG"), pursuant to a Master Easement Agreement.

EBITDA. Reflects earnings before: (i) interest income (expense), (ii) income taxes, and (iii) depreciation and amortization.

Final Arbitration Award. Damages and attorney fees and related expenses awarded to GEL Tex Marketing, LLC ("GEL") by an arbitrator on August 11, 2017, in arbitration proceedings between LE and GEL related to a contractual dispute.

General and Administrative Expenses. Primarily include corporate costs, such as accounting and legal fees, office lease expenses, and administrative expenses.

Gross Profit. Calculated as total revenue less cost of refined products sold; reflected as a dollar ($) amount.

Gross Margin. Calculated as gross profit divided by total revenue; reflected as a percentage (%).

Refining Gross Profit per Bbl. Calculated as refined petroleum product sales less cost of refined products sold divided by the volume, in bbls, of refined petroleum products sold during the period; reflected as a dollar ($) amount per bbl.

Income Tax Expense. Includes federal and state taxes, as well as deferred taxes, arising from temporary differences between income for financial reporting and income tax purposes.

Net Income (Loss). Represents total revenue from operations less total cost of operations, total other income (expense), and income tax benefit (expense).

Operating Days. Represents the number of days in a period in which the crude distillation tower operated. Operating days is calculated by subtracting downtime in a period from calendar days in the same period.

Other Income (Expense). Reflects working capital loan interest, guaranty fees earned by Jonathan Carroll, expensed interest related to long-term debt, and non-recurring income items.

Other Operating Expenses. Represents costs associated with our pipeline assets and leasehold interests in oil and gas properties.

Refinery Operating Expenses. Refinery operating expenses in our consolidated statements of operations represent: (i) Blue Dolphin's direct operating expenses, which primarily include the crude distillation tower and associated facilities, such as direct costs of labor, maintenance materials and services, chemicals and catalysts and utilities and (ii) LEH's operating fee of 5% of Blue Dolphin's direct operating expenses pursuant to the Amended and Restated Operating Agreement.

Revenue from Operations. Primarily consists of refined petroleum product sales, but also includes tank rental revenue. Excise and other taxes that are collected from customers and remitted to governmental authorities are not included in revenue. Other operations revenue relates to fees received from pipeline transportation services, which ceased in 2016.

Total Refinery Production. Refers to the volume processed as output through the crude distillation tower. Refinery production includes finished petroleum products, such as jet fuel, and intermediate petroleum products, such as naphtha, HOBM and AGO.

Total Refinery Throughput. Refers to the volume processed as input through the crude distillation tower. Refinery throughput includes crude oil and condensate and other feedstocks.

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BLUE DOLPHIN ENERGY COMPANY FORM 10-Q 6/30/18

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Consolidated Balance Sheets (Unaudited)

	June 30, 2018	December 31, 2017
	(in thousands)	
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$361	$495
Restricted cash	49	49
Accounts receivable, net	1,105	1,357
Accounts receivable, related party	-	653
Prepaid expenses and other current assets	2,317	1,207
Deposits	195	129
Inventory	4,180	3,089
Refundable federal income tax	108	-
Total current assets	8,315	6,979
LONG-TERM ASSETS		
Total property and equipment, net	64,992	64,597
Restricted cash, noncurrent	1,602	1,602
Surety bonds	230	230
Deferred tax assets, net	108	-
Total long-term assets	66,932	66,429
TOTAL ASSETS	$75,247	$73,408
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)		
CURRENT LIABILITIES		
Long-term debt less unamortized debt issue costs, current portion, in default	$35,194	35,544
Long-term debt, related party, current portion	6,060	4,000
Interest payable	2,529	2,135
Interest payable, related party	1,214	892
Accounts payable	1,958	2,344
Accounts payable, related party	1,226	974
Asset retirement obligations, current portion	2,458	2,315
Accrued expenses and other current liabilities	3,487	1,160
Accrued arbitration award payable	24,128	27,128

Total current liabilities	78,254	76,492
LONG-TERM LIABILITIES		
Deferred revenues and expenses	21	42
Capital lease obligation, net of current portion	21	-
Long-term debt, related party, net of current portion	-	1,608
Total long-term liabilities	42	1,650
TOTAL LIABILITIES	78,296	78,142
Commitments and contingencies (Note 18)		
STOCKHOLDERS' DEFICIT		
Common stock ($0.01 par value, 20,000,000 shares authorized; 10,925,513 shares issued at June 30, 2018 and December 31, 2017, respectively)	109	109
Additional paid-in capital	36,907	36,907
Accumulated deficit	(40,065)	(41,750)
TOTAL STOCKHOLDERS' DEFICIT	(3,049)	(4,734)
TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT	$75,247	$73,408

See accompanying notes to consolidated financial statements.

BLUE DOLPHIN ENERGY COMPANY FORM 10-Q 6/30/18

Consolidated Statements of Operations (Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
	(in thousands, except share and per-share amounts)			
REVENUE FROM OPERATIONS				
Refinery operations	$88,265	$56,633	$159,777	$108,535
Tolling and terminaling	850	704	1,584	1,407
Total revenue from operations	89,115	57,337	161,361	109,942
COST OF OPERATIONS				
Cost of refined products sold	83,867	54,625	152,591	106,399
Refinery operating expenses	1,377	1,652	3,299	4,465
Other operating expenses	56	54	100	115
Arbitration award and associated fees	-	24,339	-	24,339
General and administrative expenses	688	708	1,348	1,614
Depletion, depreciation and amortization	463	449	918	900
Accretion of asset retirement obligations	78	72	144	144
Total cost of operations	86,529	81,899	158,400	137,976
Income (loss) from operations	2,586	(24,562)	2,961	(28,034)
OTHER INCOME (EXPENSE)				
Easement, interest and other income	1	1	2	383
Interest and other expense	(751)	(832)	(1,495)	(1,426)
Gain on disposal of property	-	-	-	1,834
Total other income (expense)	(750)	(831)	(1,493)	791
Income (loss) before income taxes	1,836	(25,393)	1,468	(27,243)
Income tax benefit	-	-	217	-
Net income (loss)	$1,836	$(25,393)	$1,685	$(27,243)
Income (loss) per common share:				
Basic	$0.17	$(2.39)	$0.15	$(2.58)
Diluted	$0.17	$(2.39)	$0.15	$(2.58)
Weighted average number of common shares outstanding:				
Basic	10,925,513	10,637,101	10,925,513	10,556,356
Diluted	10,925,513	10,637,101	10,925,513	10,556,356

See accompanying notes to consolidated financial statements.

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BLUE DOLPHIN ENERGY COMPANY FORM 10-Q 6/30/18

Consolidated Statements of Cash Flows (Unaudited)

	Six Months Ended June 30,	
	2018	2017
	(in thousands)	
OPERATING ACTIVITIES		
Net income (loss)	$1,685	$(27,243)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depletion, depreciation and amortization	918	900
Deferred income tax	(216)	-
Amortization of debt issue costs	64	64
Accretion of asset retirement obligations	144	144
Common stock issued for services	-	30
Changes in operating assets and liabilities		
Accounts receivable	252	1,586
Accounts receivable, related party	653	1,162
Prepaid expenses and other current assets	(1,110)	(57)
Deposits and other assets	(66)	(25)
Inventory	(1,091)	(1,773)
Accrued arbitration award	(3,000)	31,279
Accounts payable, accrued expenses and other liabilities	2,635	(11,336)
Accounts payable, related party	252	302
Net cash provided by (used in) operating activities	1,120	(4,967)
INVESTING ACTIVITIES		
Capital expenditures	(1,231)	(1,408)
Net cash used in investing activities	(1,231)	(1,408)
FINANCING ACTIVITIES		
Payments on debt	(475)	(855)
Net activity on related-party debt	452	3,257
Net cash provided by (used in) financing activities	(23)	2,402
Net change in cash, cash equivalents, and restricted cash	(134)	(3,973)
CASH, CASH EQUIVALENTS, AND RESTRICTED CASH AT BEGINNING OF PERIOD	2,146	6,083
CASH, CASH EQUIVALENTS, AND RESTRICTED CASH AT END OF PERIOD	$2,012	$2,110

Supplemental Information:

Non-cash investing and financing activities:		
Financing of capital expenditures via accounts payable and capital leases	$82	1,462
Financing of guaranty fees via long-term debt, related party	$325	$111
Conversion of accounts payable to short-term notes	$-	$-
Conversion of related-party notes to common stock	$-	$831
Interest paid	$1,290	$1,333
Income taxes paid	$-	$-

See accompanying notes to consolidated financial statements.

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Notes to Consolidated Financial Statements

(1) Organization

Nature of Operations. Blue Dolphin Energy Company ("Blue Dolphin") is a publicly-traded Delaware corporation primarily engaged in the refining and marketing of petroleum products. We also provide tolling and storage terminaling services. Our assets, which are located in Nixon, Texas, primarily include a 15,000-bpd crude distillation tower and approximately 1.1 million bbls of petroleum storage tanks (collectively the "Nixon Facility"). Pipeline transportation and oil and gas operations are no longer active.

Structure and Management. Blue Dolphin is controlled by Lazarus Energy Holdings, LLC ("LEH"). LEH operates and manages all Blue Dolphin properties pursuant to an Amended and Restated Operating Agreement (the "Amended and Restated Operating Agreement"). Jonathan Carroll is Chairman of the Board of Directors (the "Board"), Chief Executive Officer, and President of Blue Dolphin, as well as a majority owner of LEH. Together LEH and Jonathan Carroll own 80.2% of our common stock, par value $0.01 per share (the "Common Stock"). (See "Note (9) Related Party Transactions," "Note (11) Long-Term Debt, Net" and "Note (18) Commitments and Contingencies – Financing Agreements" for additional disclosures related to LEH, the Amended and Restated Operating Agreement, and Jonathan Carroll.)

We have the following active subsidiaries:

Nixon Product Storage, LLC, a Delaware limited liability company ("NPS").

Lazarus Energy, LLC, a Delaware limited liability company ("LE").

Lazarus Refining & Marketing, LLC, a Delaware limited liability company ("LRM").

Blue Dolphin Pipe Line Company, a Delaware corporation ("BDPL").

Blue Dolphin Petroleum Company, a Delaware corporation.

Blue Dolphin Services Co., a Texas corporation ("BDSC").

Effective June 12, 2018, Blue Dolphin acquired 100% of the issued and outstanding membership interests of NPS from Lazarus Midstream Partners, L.P., an affiliate of LEH, pursuant to an Assignment Agreement. The assignment was accounted for as a combination of entities under common control. See "Note (5) NPS Assignment" of this Quarterly Report for further information related to the NPS assignment.

See "Part I, Item 1. Business" and "Item 2. Properties" in the Annual Report for additional information regarding our operating subsidiaries, principal facilities, and assets.

References in this Quarterly Report to “we,” “us,” and “our” are to Blue Dolphin and its subsidiaries unless otherwise indicated or the context otherwise requires.

Going Concern. Management has determined that certain factors raise substantial doubt about our ability to continue as a going concern. These factors include the following:

Final Arbitration Award and Settlement Agreement – As previously disclosed, LE was involved in arbitration proceedings (the “GEL Arbitration”) with GEL Tex Marketing, LLC (“GEL”), an affiliate of Genesis Energy, LP (“Genesis”), related to a contractual dispute involving a Crude Oil Supply and Throughput Services Agreement (the “Crude Supply Agreement”) and a Joint Marketing Agreement (the “Joint Marketing Agreement”), each between LE and GEL and dated August 12, 2011. On August 11, 2017, the arbitrator delivered its final award in the GEL Arbitration (the “Final Arbitration Award”). The Final Arbitration Award denied all of LE’s claims against GEL and granted substantially all the relief requested by GEL in its counterclaims. Among other matters, the Final Arbitration Award awarded damages and GEL’s attorneys’ fees and related expenses to GEL in the aggregate amount of approximately $31.3 million. As of the date of this report, LE has paid $7.6 million to GEL, which amount has been applied to reduce the balance of the Final Arbitration Award.

As previously disclosed, a hearing on confirmation of the Final Arbitration Award was scheduled to occur on September 18, 2017 in state district court in Harris County, Texas. Prior to the scheduled hearing, LE and GEL jointly notified the court that the hearing would be continued for a period of no more than 90 days after September 18, 2017 (the “Continuance Period”), to facilitate settlement discussions between the parties. On September 26, 2017, LE and Blue Dolphin, together with LEH and Jonathan Carroll, entered into a Letter Agreement with GEL, effective September 18, 2017 (the “GEL Letter Agreement”), confirming the parties’ agreement to the continuation of the confirmation hearing during the Continuance Period, subject to the terms of the GEL Letter Agreement. The GEL Letter Agreement was subsequently amended nine times to extend the Continuance Period through July 2018.

On July 20, 2018, LE, NPS, and Blue Dolphin, together with LEH, Carroll & Company Financial Holdings, L.P. (“C&C”), and Jonathan Carroll (collectively referred to herein as the “Lazarus Parties”), entered into a Settlement Agreement with GEL (the “Settlement Agreement”), whereby GEL and the Lazarus Parties agreed to mutually release all claims against each other and to file a stipulation of dismissal with prejudice in connection with the GEL Arbitration (the “Settlement”), subject to the terms and conditions set forth in the Settlement Agreement. The Settlement is conditioned upon payment by the Lazarus Parties to GEL of $10.0 million in cash (the “Settlement Payment”) and $0.5 million in cash at the end of each calendar month until the Settlement Payment is paid (the “Interim Payments”) or the Settlement Agreement is terminated. The Interim Payments will not be applied to reduce the amount of the Settlement Payment, but such payments will reduce the Final Arbitration Award. At June 30, 2018 and December 31, 2017, accrued arbitration award payable on our consolidated balance sheet was $24.1 million and $27.1 million, respectively. At the time of the Settlement, the difference between the Settlement Payment and the amount we have accrued on our consolidated balance sheet for arbitration award payable will be recognized as a gain on our consolidated statement of operations.

The Settlement Agreement restricts the Lazarus Parties from taking certain actions without the prior written consent of GEL, including: (i) the incurrence of any debt not specifically excepted in the Settlement Agreement, (ii) the establishment of any liens not specifically excepted in the Settlement Agreement, (iii) the disposition of any assets other than certain ordinary course sales to unaffiliated third parties, payments to unaffiliated third-party trade creditors and scheduled debt payments, (iv) the entrance into any transactions with affiliates not specifically excepted in the Settlement Agreement, (v) the failure to pay debts generally as they become due, and (vi) the entrance into a bankruptcy, reorganization or similar proceeding. A violation of any of the restrictions in the Settlement Agreement, as well as the failure of the Lazarus Parties to make Interim Payments as they become due, will constitute an event of default under the Settlement Agreement which, subject to certain cure periods, would allow GEL to terminate the Settlement Agreement and enforce its rights under the Final Arbitration Award.

The Lazarus Parties are exploring the possibility of obtaining a commercial loan in an aggregate principal amount equal to the Settlement Payment (the “Settlement Financing”), subject to obtaining the consent of Veritex Community Bank (“Veritex”), as lender under certain loan agreements with the Lazarus Parties and their affiliates. Under the Settlement Agreement, the Lazarus Parties are required to work in good faith and take reasonable actions necessary to obtain the Settlement Financing in accordance with the terms of the Settlement Agreement. Prior to the consummation of the Settlement Financing, the Lazarus Parties are required to: (i) cause NPS to consummate the Settlement Financing and restrict its ability to commence a bankruptcy case, (ii) assign to NPS certain tank leases that will constitute collateral for the Settlement Financing, and (iii) cause NPS to assume joint and several liability for all or a portion of the Final Arbitration Award. The failure to achieve certain milestones in connection with obtaining the Settlement Financing will constitute an event of default under the Settlement Agreement, which would allow GEL to terminate the Settlement Agreement and enforce its rights under the Final Arbitration Award.

Simultaneously with the execution of the Settlement Agreement, Jonathan Carroll and C&C entered into a Security Agreement pursuant to which Jonathan Carroll and C&C agreed to secure up to $10.0 million of LE's obligations under the Final Arbitration Award with a security interest in their equity in LEH.

The Settlement Agreement will terminate, unless extended in writing by GEL, on December 31, 2018 if the Settlement Payment is not made on or before such date, and the Settlement Agreement may be terminated by GEL following the occurrence of an event of default under the Settlement Agreement, as described above. Pursuant to the Settlement Agreement, the parties agreed to terminate the Letter Agreement, and GEL agreed not to take any action to execute or collect on the Final Arbitration Award and to take all action necessary to continue the District Court Action until the earlier of: (i) the date on which the Settlement Payment is paid or (ii) the termination of the Settlement Agreement.

Blue Dolphin can provide no assurance that the conditions necessary for consummation of the Settlement will be met. If certain conditions are not met or the Settlement Agreement is terminated, GEL may seek to enforce the Final Arbitration Award against the Lazarus Parties, in which case: (i) our business operations, including crude oil and condensate procurement and our customer relationships; financial condition; and results of operations will be materially affected, and (ii) Blue Dolphin and its affiliates would likely be required to seek protection under bankruptcy laws.

Veritex Secured Loan Agreement Event of Default – Veritex, as successor in interest to Sovereign Bank by merger, delivered to obligors notices of default under secured loan agreements with Veritex, stating that the Final Arbitration Award constitutes an event of default under the secured loan agreements. The occurrence of an event of default permits Veritex to declare the amounts owed under these loan agreements immediately due and payable, exercise its rights with respect to collateral securing obligors' obligations under these loan agreements, and/or exercise any other rights and remedies available. Veritex informed obligors that it is not currently exercising its rights and remedies under the secured loan agreements considering the Settlement Agreement. However, Veritex expressly reserved all of its rights, privileges and remedies related to events of default under the secured loan agreements and informed obligors that it would consider a final confirmation of the Final Arbitration Award to be a material event of default under the loan agreements. Additionally, Veritex must ultimately approve the Settlement. The debt associated with loans under secured loan agreements was classified within the current portion of long-term debt on our consolidated balance sheet at June 30, 2018 due to existing events of default related to the Final Arbitration Award as well as the uncertainty of LE and LRM's ability to meet financial covenants in the secured loan agreements in the future.

We can provide no assurance as to whether Veritex, as first lienholder, will approve the Settlement. If Veritex does not approve the Settlement Agreement, any exercise by Veritex of its rights and remedies under the secured loan agreements would have a material adverse effect on our business, financial condition, and results of operations, and Blue Dolphin would likely be required to seek protection under bankruptcy laws.

Operating Risks. Successful execution of our business plan depends on several key factors, including the Settlement with GEL, having adequate crude oil and condensate supplies, maintaining safe and reliable operations at the Nixon Facility, improving margins on refined petroleum products, and meeting contractual obligations. (See "Part I, Item 1. Business – Business Strategies" in the Annual Report for information related to our business plan.)

For the quarter ended June 30, 2018, we reported net income of $1.8 million, or income of $0.17 per share, compared to a net loss of $25.4 million, or a loss of $2.39 per share, for the quarter ended June 30, 2017. The prior period in 2017 included the Final Arbitration Award, which was $24.3 million and represented an expense of $2.32 per share. Including the Final Arbitration Award, net income (loss) on a per share basis improved $2.56 between the periods. Excluding the Final Arbitration Award, net income (loss) on a per share basis improved $0.27 between the periods, which was primarily the result of improved margins for refined petroleum products.

For the six months ended June 30, 2018, we reported net income of $1.7 million, or income of $0.15 per share, compared to a net loss of $27.2 million, or a loss of $2.58 per share, for the six months ended June 30, 2017. Including the Final Arbitration Award, net income (loss) on a per share basis improved $2.73 between the periods. Excluding the Final Arbitration Award, net income (loss) on a per share basis improved $0.43 between the periods, which was primarily the result of improved margins for refined petroleum products.

Execution of our business plan was hindered during the quarter ended June 30, 2018 by several factors, including:

Working Capital Deficits – We had a working capital deficit of $69.9 million at June 30, 2018 compared to a working capital deficit of $69.5 million at December 31, 2017. Excluding the current portion of long-term debt, we had a working capital deficit of $28.7 million at June 30, 2018 compared to a working capital deficit of $30.0 million at December 31, 2017.

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Crude Supply – We currently have in place a month-to-month evergreen crude supply contract with a major integrated oil and gas company. This supplier currently provides us with adequate amounts of crude oil and condensate, and we expect the supplier to continue to do so for the foreseeable future. However, our ability to purchase adequate amounts of crude oil and condensate is dependent on our liquidity and access to capital, which could be adversely affected if the Settlement Agreement is terminated and GEL seeks to confirm and enforce the Final Arbitration Award, and other factors, as noted above.

Financial Covenant Defaults – In addition to existing events of default related to the Final Arbitration Award, at June 30, 2018 LE and LRM were in violation of certain financial covenants in secured loan agreements with Veritex. Covenant defaults under the secured loan agreements would permit Veritex to declare the amounts owed under these loan agreements immediately due and payable, exercise its rights with respect to collateral securing obligors' obligations under these loan agreements, and/or exercise any other rights and remedies available. The debt associated with these loans was classified within the current portion of long-term debt on our consolidated balance sheet at June 30, 2018 due to existing events of default related to the Final Arbitration Award as well as the uncertainty of LE and LRM's ability to meet the financial covenants in the future. There can be no assurance that Veritex will provide a waiver of events of default related to the Final Arbitration Award, consent to the Settlement Agreement with GEL, or provide future waivers of any financial covenant defaults, which would have an adverse impact on our financial position and results of operations.

We are continuing aggressive actions in 2018 to improve operations and liquidity. Management believes that it is continuing to take the appropriate steps to improve operations at the Nixon Facility and our overall financial stability. However, there can be no assurance that our business plan will be successful, that LEH and its affiliates will continue to fund our working capital needs, or that we will be able to obtain additional financing on commercially reasonable terms or at all. If Veritex does not approve the Settlement or if the Settlement Agreement with GEL is terminated and GEL seeks to confirm and enforce the Final Arbitration Award, our business, financial condition, and results of operations will be materially adversely affected, and Blue Dolphin and its affiliates would likely be required to seek protection under bankruptcy laws.

For additional disclosures related to the Final Arbitration Award, the GEL Letter Agreement, the Settlement Agreement, defaults under secured loan agreements, and risk factors that could materially affect our future business, financial condition and results of operations, refer to the following sections in this Quarterly Report:

Part I, Item 1. Financial Statements, Notes to Consolidated Financial Statements:

- Note (9) Related Party Transactions
- Note (11) Long-Term Debt, Net
- Note (18) Commitments and Contingencies – Legal Matters
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Note (19) Subsequent Events

Part I, Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations:

- Final Arbitration Award

- Results of Operations

- Liquidity and Capital Resources

Part II, Item 1. Legal Proceedings

Part II, Item 1A. Risk Factors

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(2) Basis of Presentation

The accompanying unaudited consolidated financial statements, which include Blue Dolphin and its subsidiaries, have been prepared in accordance with GAAP for interim consolidated financial information pursuant to the rules and regulations of the SEC under Article 10 of Regulation S-X and the instructions to Form 10-Q. Accordingly, certain information and footnote disclosures normally included in our audited financial statements have been condensed or omitted pursuant to the SEC's rules and regulations. Significant intercompany transactions have been eliminated in the consolidation. In management's opinion, all adjustments considered necessary for a fair presentation have been included, disclosures are adequate, and the presented information is not misleading.

The consolidated balance sheet as of December 31, 2017 was derived from the audited financial statements at that date. The accompanying consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report. Operating results for the three and six months ended June 30, 2018 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2018, or for any other period.

(3) Significant Accounting Policies

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

Use of Estimates. We have made several 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. We believe our current estimates are reasonable and appropriate, however, actual results could differ from those estimated.

Cash and Cash Equivalents. Cash and cash equivalents represent 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, may exceed insured deposit limits. We monitor the financial condition of the financial institutions and have experienced no losses associated with these accounts.

Restricted Cash. Restricted cash (current portion) primarily represents: (i) amounts held in our disbursement account with Veritex attributable to construction invoices awaiting payment from that account, (ii) a payment reserve account held by Veritex as security for payments under a loan agreement, and (iii) a construction contingency account under which Veritex will fund contingencies. Restricted cash, noncurrent represents funds held in the Veritex disbursement account for payment of future construction related expenses to build new petroleum storage tanks.

Accounts Receivable and Allowance for Doubtful Accounts. Our accounts receivable consists of customer obligations due in the ordinary course of business. Since we have a small number of customers with individually large amounts due on any given date, we evaluate potential and existing customers' financial condition, credit worthiness, and payment history to minimize credit risk. Allowance for doubtful accounts is based on a combination of current sales and specific identification methods. If necessary, we establish an allowance for doubtful accounts to estimate the amount of probable credit losses. Allowance for doubtful accounts totaled $0.1 million and $0 at June 30, 2018 and December 31, 2017, respectively.

Inventory. Our inventory primarily consists of refined petroleum products, crude oil and condensate, and chemicals. Inventory is valued at lower of cost or net realizable value with cost being determined by the average cost method, and net realizable value being determined based on estimated selling prices less any associated delivery costs. If the net realizable value of our refined petroleum products inventory declines to an amount less than our average cost, we record a write-down of inventory and an associated adjustment to cost of refined products sold. (See "Note (7) Inventory" for additional disclosures related to our inventory.)

Property and Equipment.

Refinery and Facilities. Management expects to continue making improvements to the crude distillation tower based on operational needs and technological advances. Additions to refinery and facilities assets are capitalized. Expenditures for repairs and maintenance are expensed as incurred and included as operating expenses under the Amended and Restated Operating Agreement.

We record refinery and facilities at cost less any adjustments for depreciation or impairment. Adjustment of the asset and the related accumulated depreciation accounts are made for the refinery and facilities asset's retirement and disposal, with the resulting gain or loss included in the consolidated statements of operations. For financial reporting purposes, depreciation of refinery and facilities assets is computed using the straight-line method using an estimated useful life of 25 years beginning when the refinery and facilities assets are placed in service. As a result of the Final Arbitration Award, which represents a significant adverse change that could affect the value of a long-lived asset, management performed potential impairment testing of our refinery and facilities assets in the fourth quarter of 2017. Upon completion of that testing, we determined that no impairment was necessary at December 31, 2017. We did not record any impairment of our refinery and facilities assets for the periods presented.

Pipelines and Facilities. Our pipelines and facilities are recorded at cost less any adjustments for depreciation or impairment. Depreciation is computed using the straight-line method over estimated useful lives ranging from 10 to 22 years. In accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") guidance on accounting for the impairment or disposal of long-lived assets, management performed periodic impairment testing of our pipeline and facilities assets in the fourth quarter of 2016. Upon completion of that testing, our pipeline assets were fully impaired. All pipeline transportation services to third-parties have ceased, existing third-party wells along our pipeline corridor have been permanently abandoned, and no new third-party wells are being drilled near our pipelines. However, management believes our pipeline assets have future value based on large-scale, third-party production facility expansion projects near the pipelines.

Oil and Gas Properties. Our oil and gas properties are accounted for using the full-cost method of accounting, whereby all costs associated with acquisition, exploration and development of oil and gas properties, including directly related internal costs, are capitalized on a cost center basis. Amortization of such costs and estimated future development costs are determined using the unit-of-production method. All leases associated with our oil and gas properties have expired, and our oil and gas properties were fully impaired in 2011.

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

(See "Note (8) Property, Plant and Equipment, Net" for additional disclosures related to our refinery and facilities assets, oil and gas properties, pipelines and facilities assets, and construction in progress.)

Intangibles – Other. Trade name, an intangible asset, represents the "Blue Dolphin Energy Company" brand name. We account for intangible assets under FASB ASC guidance related to intangibles, goodwill, and other. Under the guidance, we determined trade name to have an indefinite useful life, and we test intangible assets with indefinite lives annually for impairment. Management performed its regular annual impairment testing of trade name in the fourth quarter of 2017. Upon completion of that testing, our trade name asset was fully impaired at December 31, 2017.

Debt Issue Costs. We have debt issue costs related to certain refinery and facilities assets 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. Debt issue costs are presented net with the related debt liability. (See “Note (11) Long-Term Debt, Net” for additional disclosures related to debt issue costs.)

Revenue Recognition.

We adopted the provisions of FASB ASU 2014-09, Revenue from Contracts with Customers (ASC 606), on January 1, 2018, as described below in "New Pronouncements Adopted." Accordingly, our revenue recognition accounting policy has been revised to reflect the adoption of this standard.

Refinery Operations Revenue. Revenue from the sale of refined petroleum products is recognized when the product is sold to a customer in fulfillment of performance obligations. Each barrel of refined petroleum product, or other unit of measure, is separately identifiable and represents a distinct performance obligation to which the transaction price is allocated. Performance obligations are met when control is transferred to the customer in accordance with the terms of the respective sales agreement. We consider a variety of facts and circumstances in assessing the point of control transfer, including but not limited to: whether the purchaser can direct the use of the refined petroleum product, the transfer of significant risks and rewards, our rights to payment, and transfer of legal title. In each case, the term between delivery and when payments are due is not significant. Transportation, shipping, and handling costs incurred are included in cost of refined products sold. Excise and other taxes that are collected from customers and remitted to governmental authorities are not included in revenue.

Tolling and Terminaling Revenue. Revenues for tolling and terminaling include fees pursuant to: (i) tolling agreements, whereby a customer agrees to pay a certain fee per gallon or barrel for throughput volumes moving through the naphtha stabilizer unit and a fixed monthly reservation fee for use of the naphtha stabilizer unit and (ii) tank storage agreements, whereby a customer agrees to pay a certain fee per tank based on tank size over a period of time for the storage of products. We typically satisfy performance obligations for tolling and terminaling operations with the passage of time. We determine the transaction price at agreement inception based on the guaranteed minimum amount of revenue over the term of the agreement. We allocate the transaction price to the single performance obligation that exists under the agreement, and we recognize revenue in the amount for which we have a right to invoice. Generally, payment terms do not exceed 30 days.

Revenue from tank storage customers may, from time to time, include fees for ancillary services, such as in-tank and tank-to-tank blending. These services are considered optional to the customer, and the price we charge for such services is not included in the fixed cost under the customer's tank storage agreement. Ancillary services do not provide a material right to the customer, and such services are considered a separate performance obligation by us under the tank storage agreement. The performance obligation is satisfied when the requested service has been performed in the applicable period.

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 reporting period 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.

As of each reporting date, management considers new evidence, both positive and negative, to determine the realizability of deferred tax assets. Management considers whether it is more likely than not that a portion or all of the deferred tax assets will be realized, which is dependent upon the generation of future taxable income prior to the expiration of any net operating loss ("NOL") carryforwards. When management determines that it is more likely than not that a tax benefit will not be realized, a valuation allowance is recorded to reduce deferred tax assets. A significant piece of objective negative evidence evaluated was the cumulative loss incurred over the three-year period ended December 31, 2017. Such objective evidence limits the ability to consider other subjective evidence, such as our projections for future growth. Based on this evaluation, we recorded a valuation allowance against the deferred tax assets for which realization was not deemed more likely than not as of June 30, 2018 and December 31, 2017. We expect to recover deferred tax assets related to the Alternative Minimum Tax ("AMT").

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The benefit of an uncertain tax position is recognized in the financial statements if it meets a minimum recognition threshold. A determination is first made as to whether it is more likely than not that the income tax position will be sustained, based upon technical merits, upon examination by the taxing authorities. If the income tax position is expected to meet the more-likely-than-not criteria, the benefit recorded in the financial statements equals the largest amount that is greater than 50% likely to be realized upon its ultimate settlement. At June 30, 2018 and December 31, 2017, there were no uncertain tax positions for which a reserve or liability was necessary. (See "Note (16) Income Taxes" for further information related to income taxes.)

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 periodically evaluate our long-lived assets for impairment. Additionally, we evaluate our long-lived assets when events or circumstances indicate that the carrying value of these assets may not be recoverable. The carrying value is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset or group of assets. If the carrying value exceeds the sum of the undiscounted cash flows, an impairment loss equal to the amount by which the carrying value exceeds the fair value of the asset or group of assets is recognized. 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. As a result of the Final Arbitration Award, which represents a significant adverse change that could affect the value of a long-lived asset, management performed potential impairment testing of our refinery and facilities assets in the fourth quarter of 2017. Upon completion of that testing, we determined that no impairment was necessary at December 31, 2017. We did not record any impairment of our refinery and facilities assets for the periods presented.

Asset Retirement Obligations. FASB ASC guidance related to asset retirement obligations ("AROs") requires that a liability for the discounted fair value of an ARO be recorded in the period in which 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 assets. 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 legal or contractual obligation to dismantle or remove the refinery and facilities assets arises and 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 for plugging and abandoning wells and restoring land and sea beds. We developed these cost estimates for each of our assets based upon regulatory requirements, structural makeup, water depth, reservoir characteristics, reservoir depth, equipment demand, current retirement procedures, and construction and engineering consultations. Because these costs typically extend many years into the future, estimating 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. (See "Note (12) Asset Retirement Obligations" for additional information related to our AROs.)

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 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 our consolidated statements of operations and requires a reconciliation of the denominator of basic EPS and diluted EPS. Diluted EPS is computed by dividing net income 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.

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 that has not yet been recognized and the amount of any current and deferred tax benefit 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. (See "Note (17) Earnings Per Share" for additional information related to EPS.)

Treasury Stock. We accounted for treasury stock under the cost method. In May 2017, our treasury stock was re-issued. The net change in share price after acquisition of the treasury stock was recognized as a component of additional paid-in-capital in our consolidated balance sheets. (See "Note (13) Treasury Stock" for additional disclosures related to treasury stock.)

New Pronouncements Adopted. The FASB issues an Accounting Standards Update ("ASU") to communicate changes to the FASB ASC, including changes to non-authoritative SEC content. Recently adopted ASUs include:

ASU 2014-09, Revenue from Contracts with Customers (ASC 606). We adopted this accounting pronouncement effective January 1, 2018, using a modified retrospective approach, which required us to apply the new revenue standard to: (i) all new revenue contracts entered into after January 1, 2018 and (ii) all existing revenue contracts as of January 1, 2018. In accordance with this approach, our consolidated revenues for the periods prior to January 1, 2018 will not be revised. Our implementation activities related to ASC 606 are complete, and we will not have any material differences in the amount or timing of revenues as a result of the adoption of ASC 606. Our largest revenue streams consist of orders received from our customers for crude-oil derived specialty products based on market prices. These revenues are recognized at a point in time upon transfer of control of the product in accordance with contractual terms.

New Pronouncements Issued, Not Yet Effective. The following are recently issued, but not yet effective, ASU's that may influence our consolidated financial position, results of operations, or cash flows:

ASUs 2018-10 and 2016-02, Leases (Topic 842). In February 2016, FASB issued ASU 2016-02. This guidance increases transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. In July 2018, FASB issued ASU 2018-10. The amendments in ASU 2018-10 affect narrow aspects of the guidance issued in the amendments in ASU 2016-02. For a public business entity, the amendments in ASU 2018-10 affect the amendments in ASU 2016-02, which are not yet effective, but for which early adoption upon issuance is permitted. For entities that early adopted Topic 842, the amendments are effective upon issuance of ASU 2018-10, and the transition requirements are the same as those in Topic 842. For entities that have not adopted Topic 842, the effective date and transition requirements will be the same as the effective date and transition requirements in Topic 842. We do not expect adoption of this guidance to have a significant impact on our consolidated balance sheets.

ASU 2018-09, Codification Improvements. In July 2018, FASB issued ASU 2018-09. This guidance affects a wide variety of topics in the codification and represents changes to clarify, correct errors in, or make minor improvements to the codification. The amendments make the codification easier to understand and easier to apply by eliminating inconsistencies and providing clarifications. The amendments apply to all reporting entities within the scope of the affected accounting guidance. Some of the amendments in ASU 2018-09 do not require transition guidance and will be effective upon issuance. However, many of the amendments do have transition guidance with effective dates for annual periods beginning after December 15, 2018, for public business entities. We are currently evaluating the impact ASU 2018-09 may have on our consolidated financial statements.

ASU 2018-07, Compensation – Stock Compensation (Topic 718). In June 2018, FASB issued ASU 2018-07. This guidance expands the scope of Topic 718 to include share-based payment transactions for acquiring goods and services from non-employees. The amendments in ASU 2018-07 are effective for public business entities for fiscal years beginning after December 15, 2018, including interim periods within that fiscal year. Early adoption is permitted, but no earlier than an entity’s adoption date of Topic 606. We do not expect adoption of this guidance to have a significant impact on our consolidated financial statements.

ASU 2018-05, Income Taxes (Topic 740). In March 2018, FASB issued ASU 2018-05. This guidance amends SEC paragraphs in ASC 740, Income Taxes, to reflect SAB 118, which provides guidance for companies that are not able to complete their accounting for the income tax effects of the Tax Cuts and Jobs Act in the period of enactment. This guidance also includes amendments to the XBRL Taxonomy. For public business entities, the amendments in ASU 2018-05 are effective for fiscal years ending after December 15, 2020. Early adoption is permitted. We do not expect adoption of this guidance to have a significant impact on our consolidated financial statements.

Other new pronouncements issued but not yet effective are not expected to have a material impact on our financial position, results of operations, or liquidity.

(4) Business Segment Information

We have two reportable business segments: (i) Refinery Operations and (ii) Tolling and Terminaling. Refinery operations relate to the refining and marketing of petroleum products at our 15,000-bpd crude distillation tower. Tolling and terminaling operations relate to tolling and storage terminaling services under related-party and third-party lease agreements. Both operations are conducted at the Nixon Facility.

Business segment information for the periods indicated (and as of the dates indicated) was as follows:

	Three Months Ended June 30,						
	2018				2017		
	(in thousands)						
	Segments				Segment		
	Refinery Operations	Tolling and Terminaling	Corporate & Other	Total	Refinery Operations	Corporate & Other	Total
Revenues from external customers	$88,265	$850	$-	$89,115	$57,337	$-	$57,337
Intersegment revenues	-	875	-	875	-	-	-
Less: operation costs(1)	(85,761)	(782)	(398)	(86,941)	(81,055)	(395)	(81,450)
EBITDA(2)	$2,504	$943	$(398)		$(23,718)	$(395)	
Depletion, depreciation and amortization				(463)			(449)

Interest expense, net				(750)			(831)
Income (loss) before income taxes				1,836			(25,393)
Income tax benefit				-			-
Net income (loss)				$1,836			$(25,393)
Capital expenditures	$487	$340	$-	$827	$858	$-	$858
Identifiable assets	$54,966	$19,317	$964	$75,247	$71,436	$1,048	$72,484

(1) Operation costs within Refinery Operations includes related general and administrative expenses and the arbitration award and associated fees. Operation cost within Tolling and Terminaling includes an allocation of refinery operating expenses and other costs (e.g. insurance and maintenance), as well as associated refinery fuel costs. Operation cost within Corporate and Other includes general and administrative expenses associated with corporate maintenance costs (such as accounting fees, director fees, and legal expense), as well as expenses associated with our pipeline assets and oil and gas leasehold interests (such as accretion).

(2) EBITDA is a non-GAAP financial measure. See “Part I, Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations – Results of Operations – Non-GAAP Financial Measures” for additional information related to EBITDA.

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	Six Months Ended June 30,						
	2018				2017		
	(in thousands)						
	Segments				Segment		
	Refinery Operations	Tolling and Terminaling	Corporate & Other	Total	Refinery Operations	Corporate & Other	Total
Revenues from external customers	$159,777	$1,584	$-	$161,361	$109,942	$-	$109,942
Intersegment revenues	-	1,546	-	1,546	-	-	-
Less: operation costs(1)	(156,676)	(1,510)	(842)	(159,028)	(136,250)	(825)	(137,075)
Other non-interest income(2)	-	-	-	-	-	2,216	2,216
EBITDA(3)	$3,101	$1,620	$(842)		$(26,308)	$1,391	
Depletion, depreciation and amortization				(918)			(900)
Interest expense, net				(1,493)			(1,426)
Income (loss) before income taxes				1,468			(27,243)
Income tax benefit				217			-
Net income (loss)				$1,685			$(27,243)
Capital expenditures	$905	$544	$-	$1,449	$2,889	$-	$2,889
Identifiable assets	$54,966	$19,317	$964	$75,247	$71,436	$1,048	$72,484

(1) Operation costs within Refinery Operations includes related general and administrative expenses and the arbitration award and associated fees. Operation cost within Tolling and Terminaling includes an allocation of refinery operating expenses and other costs (e.g. insurance and maintenance), as well as associated refinery fuel costs. Operation cost within Corporate and Other includes general and administrative expenses associated with

corporate maintenance costs (such as accounting fees, director fees, and legal expense), as well as expenses associated with our pipeline assets and oil and gas leasehold interests (such as accretion).

(2) Other non-interest income reflects FLNG Land II, Inc. easement revenue. See “Note (18) Commitments and Contingencies – FLNG Easements” for further discussion related to FLNG.

(3) EBITDA is a non-GAAP financial measure. See “Part I, Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations – Results of Operations – Non-GAAP Financial Measures” for additional information related to EBITDA.

(5) NPS Assignment

Effective June 12, 2018, Blue Dolphin obtained 100% of the issued and outstanding membership interest of NPS, a Delaware limited liability company, from Lazarus Midstream Partners, L.P. (“Lazarus Midstream”), an affiliate of LEH, pursuant to an Assignment Agreement. The assignment of interest facilitates the Lazarus Parties exploring the possibility of obtaining the Settlement Financing under the Settlement Agreement.

The assignment was accounted for as a combination of entities under common control. Accordingly, the recognized assets and liabilities of NPS were transferred at their carrying amounts at the date of transfer and the results of operations are included for the three and six months ended June 30, 2018. NPS did not have significant assets, liabilities or results of operations for the three and six months ended June 30, 2017. Assets and liabilities included in the consolidated balance sheets were $0.3 million and $0, respectively, as of June 30, 2018. NPS provides petroleum storage services at the Nixon Facility. NPS’ operations are included in our Tolling and Terminaling business segment.

(6) Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets as of the dates indicated consisted of the following:

	June 30,	December 31,
	2018	2017
	(in thousands)	
Prepaid crude oil and condensate	$1,839	$913
Prepaid insurance	478	294
	$2,317	$1,207

(7) Inventory

Inventory as of the dates indicated consisted of the following:

	June 30,	December 31,
	2018	2017
	(in thousands)	
AGO	$1,945	$213
Crude oil and condensate	1,573	961
Naphtha	417	170
Chemicals	224	162
Propane	16	17
LPG mix	5	8
HOBM	-	1,558
	$4,180	$3,089

(8) Property, Plant and Equipment, Net

Property, plant and equipment, net, as of the dates indicated consisted of the following:

	June 30,	December 31,

	2018	2017
	(in thousands)	
Refinery and facilities	$54,114	$51,432
Land	566	566
Other property and equipment	747	653
	55,427	52,651
Less: Accumulated depletion, depreciation, and amortization	(9,414)	(8,495)
	46,013	44,156
Construction in progress	18,979	20,441
	$64,992	$64,597

We capitalize interest cost incurred on funds used to construct property, plant, and equipment. Capitalized interest, which is recorded as part of the asset to which it relates, is depreciated over the asset's useful life. Interest cost capitalized, which is currently included in construction in progress, was $3.7 million and $3.9 million at June 30, 2018 and December 31, 2017, respectively. We expect construction of petroleum storage tanks at the Nixon Facility to continue until year end.

(9) Related Party Transactions

Blue Dolphin and certain of its subsidiaries are party to several agreements with LEH and its affiliates. Management believes that these related party transactions were consummated on terms equivalent to those that prevail in arm's-length transactions.

Related Parties.

LEH. LEH is our controlling shareholder. Jonathan Carroll, Chairman of the Board, Chief Executive Officer, and President of Blue Dolphin, is the majority owner of LEH. Together LEH and Jonathan Carroll own 80.2% of our Common Stock. Related party agreements with LEH include: (i) an Amended and Restated Operating Agreement with Blue Dolphin and LE, (ii) a Jet Fuel Sales Agreement with LE, (iii) a Loan Agreement with BDPL, (iv) an Amended and Restated Promissory Note with Blue Dolphin, and (v) a Debt Assumption Agreement with LE. Additionally, effective June 12, 2018, Blue Dolphin obtained 100% of the issued and outstanding membership interest of NPS from Lazarus Midstream pursuant to an Assignment Agreement. (See “Note (5) NPS Assignment” for further discussion related to the NPS transaction.)

Ingleside Crude, LLC (“Ingleside”). Ingleside is a related party of LEH and Jonathan Carroll. Blue Dolphin is party to an Amended and Restated Promissory Note with Ingleside.

Lazarus Marine Terminal I, LLC (“LMT”). LMT is a related party of LEH and Jonathan Carroll. LE is party to a Dock Tolling Agreement with LMT.

Jonathan Carroll. Jonathan Carroll is Chairman of the Board, Chief Executive Officer, and President of Blue Dolphin. Related party agreements with Jonathan Carroll include: (i) Amended and Restated Guaranty Fee Agreements with LE and LRM and (ii) an Amended and Restated Promissory Note with Blue Dolphin.

Currently, we depend on LEH and its affiliates (including Jonathan Carroll and Ingleside) for financing when revenue from operations and borrowings under bank facilities are insufficient to meet our liquidity needs. Such borrowings are reflected in our consolidated balance sheets in accounts payable, related party, and/or long-term debt, related party.

Operations Related Agreements.

Amended and Restated Operating Agreement. LEH operates and manages all Blue Dolphin properties pursuant to the Amended and Restated Operating Agreement. The Amended and Restated Operating Agreement, which was restructured following cessation of crude supply and marketing activities under the Crude Supply Agreement and Joint Marketing Agreement with GEL, expires: (i) April 1, 2020, (ii) upon written notice by either party to the Amended and Restated Operating Agreement of a material breach by the other party, or (iii) upon 90 days’ notice by the Board if the Board determines that the Amended and Restated Operating Agreement is not in our best interest. LEH receives an operating fee of 5% of Blue Dolphin’s direct operating expenses. LEH’s operating fee and Blue Dolphin’s direct operating expenses are reflected within refinery operating expenses in our consolidated statements of operations.

Jet Fuel Sales Agreement. LE sells jet fuel to LEH pursuant to a Jet Fuel Sales Agreement. LEH resells the jet fuel purchased from LE to a government agency. LEH bids for jet fuel contracts are evaluated under preferential pricing terms due to its HUBZone certification. The Jet Fuel Sales Agreement terminates on the earliest to occur of: (a) a one-year term expiring March 31, 2019 plus a 30-day carryover or (b) delivery of a maximum quantity of jet fuel as defined therein. Sales to LEH under the Jet Fuel Sales Agreement are reflected within refinery operations revenue in our consolidated statements of operations. (LRM previously leased petroleum storage tanks to LEH for the storage of the jet fuel under a Terminal Services Agreement. The Terminal Services Agreement has been terminated as described below).

Terminal Services Agreement. Pursuant to a Terminal Services Agreement, LEH leased petroleum storage tanks from LRM for the storage of LEH purchased jet fuel under the Jet Fuel Sales Agreement (as described above). The Terminal Services Agreement was terminated in June 2017. Rental fees received from LEH under the Terminal Services Agreement are reflected within tolling and terminaling revenue in our consolidated statements of operations.

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Amended and Restated Tank Lease Agreement. Pursuant to an Amended and Restated Tank Lease Agreement with Ingleside, LE leased petroleum storage tanks to meet periodic, additional storage needs. The Amended and Restated Tank Lease Agreement was terminated in July 2017. Rental fees owed to Ingleside under the tank lease agreement are reflected within long-term debt, related party, net of current portion in our consolidated balance sheets. Amounts expensed as rental fees to Ingleside under the Amended and Restated Tank Lease Agreement are reflected within refinery operating expenses in our consolidated statements of operations.

Dock Tolling Agreement. In May 2016, LE entered a Dock Tolling Agreement with LMT to facilitate loading and unloading of petroleum products by barge at LMT's dock facility in Ingleside, Texas. The Dock Tolling Agreement has a five-year term and may be terminated at any time by the agreement of both parties. LE pays LMT a flat reservation fee monthly. The reservation fee includes tolling volumes up to 84,000 gallons per day. Excess tolling volumes are subject to an increased per gallon rate. Amounts expensed as tolling fees under the Dock Tolling Agreement are reflected in the cost of refined products sold in our consolidated statements of operations.

Financial Agreements.

BDPL Loan Agreement. In August 2016, BDPL entered a loan and security agreement with LEH as evidenced by a promissory note in the original principal amount of $4.0 million (the "BDPL Loan Agreement"). The BDPL Loan Agreement matures on August 15, 2018. Interest accrues at rate of 16.00%. A final balloon payment is due at maturity.

The proceeds of the BDPL Loan Agreement were used for working capital. There are no financial maintenance covenants associated with the BDPL Loan Agreement. The BDPL Loan Agreement is secured by certain property owned by BDPL. Outstanding principal owed to LEH under the BDPL Loan Agreement is reflected in long-term debt, related party, current portion in our consolidated balance sheets. Accrued interest under the BDPL Loan Agreement is reflected in interest payable, related party, current portion in our consolidated balance sheets.

Promissory Notes. We currently rely on LEH and its affiliates (including Jonathan Carroll) to fund our working capital requirements. During 2017, LEH and its affiliates (Ingleside and Jonathan Carroll) provided working capital to Blue Dolphin in the form of non-cash advances, such as conversions of accounts payable to debt. These non-cash advances are reflected in the below promissory notes. There can be no assurance that LEH and its affiliates will continue to fund our working capital requirements. Outstanding principal and accrued interest owed under these promissory notes are reflected in long-term debt, related party, current portion in our consolidated balance sheets.

June LEH Note – In March 2017, Blue Dolphin entered a promissory note with LEH (the "March LEH Note"). In June 2017, the March LEH Note was amended and restated to increase the principal amount (the "June LEH Note"). The June LEH Note accrues interest at a rate of 8.00% and has a maturity date of January 2019. Interest under the June LEH Note, which is compounded annually and accrued at a rate of 8.00%, was paid in kind and added to the outstanding balance.

March Ingleside Note – In March 2017, a promissory note between Blue Dolphin and Ingleside was amended and restated (the "March Ingleside Note") to increase the principal and extend the maturity date to January 2019. Interest under the March Ingleside Note, which is compounded annually and accrued at a rate of 8.00%, was paid in kind and added to the outstanding balance.

March Carroll Note – In March 2017, a promissory note between Blue Dolphin and Jonathan Carroll was amended and restated (the "March Carroll Note") to increase the principal amount, revise the payment terms to reflect payment in cash and shares of Blue Dolphin Common Stock, and extend the maturity date to January 2019. Interest under the March Carroll Note, which is compounded annually and accrued at a rate of 8.00%, was paid in kind and added to the outstanding balance.

Debt Assumption Agreement. On September 18, 2017, LEH paid, on LE's behalf, certain obligations totaling $3.6 million to GEL relating to the GEL Arbitration and the GEL Letter Agreement. In exchange for such payments, LE agreed to assume $3.7 million of LEH's existing indebtedness pursuant to the Debt Assumption Agreement, entered on November 14, 2017 and made effective September 18, 2017, by and among LE, LEH and John Kissick. Debt held by John Kissick, including the debt associated with the Debt Assumption Agreement, is reported in this Quarterly Report as the Notre Dame Debt and is reflected in long-term debt less unamortized debt issue costs, current portion in our consolidated balance sheets, as it is currently in default. (See "Note (11) Long-Term Debt, Net" for further discussion related to the Notre Dame Debt.)

Amended and Restated Guaranty Fee Agreements. Pursuant to Amended and Restated Guaranty Fee Agreements, Jonathan Carroll earns fees for providing his personal guarantee on certain LE and LRM long-term debt. Jonathan Carroll was required to guarantee repayment of funds borrowed and interest accrued under certain LE and LRM loan agreements. Amounts owed to Jonathan Carroll under Amended and Restated Guaranty Fee Agreements are reflected within long-term debt, related party, net of current portion in our consolidated balance sheets. Amounts expensed related to Amended and Restated Guarantee Fee Agreements are reflected within interest and other expense in our consolidated statements of operations.

Financial Statements Impact.

Consolidated Balance Sheets. Accounts receivable, related party from LEH associated with the Jet Fuel Sales Agreement were $0 and $0.7 million at June 30, 2018 and December 31, 2017, respectively. Accounts payable, related party to LMT associated with the Dock Tolling Agreement were $1.2 million and $1.0 million at June 30, 2018 and December 31, 2017, respectively.

Long-term debt, related party associated with the BDPL Loan Agreement, March Ingleside Note, and the March Carroll Note as of the dates indicated was as follows:

	June 30,	December 31,
	2018	2017
	(in thousands)	
LEH	$4,036	$4,000
Ingleside	1,238	1,169
Jonathan Carroll	786	439
	6,060	5,608
Less: Long-term debt, related party, current portion	(6,060)	(4,000)
	$-	$1,608

Accrued interest associated with the BDPL Loan Agreement was $1.2 million and $0.9 million at June 30, 2018 and December 31, 2017, respectively.

Consolidated Statements of Operations. Related party revenue from operations as a portion of refinery operations and tolling and terminaling was as follows:

	Three Months Ended June 30,				Six Months Ended June 30,			
	2018		2017		2018		2017	
	(in thousands, except percent amounts)							
LEH								
Jet fuel product sales	$25,549	28.7%	$20,158	35.2%	$46,116	28.6%		