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TIDELANDS OIL & GAS CORP/WA
Form 10QSB
November 14, 2005

SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

Form 10-QSB

(Mark one)

Quarterly Report Under Section 13 or 15(d) of The Securities Exchange Act of 1934

For the quarterly period ending September 30, 2005

Transition Report Under Section 13 or 15(d) of The Securities Exchange Act of 1934

For the transition period from _____ to _____

Commission File Number: 0-29613

TIDELANDS OIL & GAS CORPORATION
(Exact name of small business issuer as specified in its charter)

Nevada

66-0549380

(State of incorporation)

(IRS Employer ID Number)

1862 West Bitters Rd., San Antonio, TX 78248

(Address of principal executive offices)

(210) 764-8642

(Issuer's telephone number)

Securities registered under Section 12 (b) of the Exchange Act: None

Securities registered under Section 12(g) of the Exchange Act: Common Stock -
\$0.001 par value

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

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PRECEDING FIVE YEARS Check whether the registrant filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Exchange Act after the distribution of securities under a plan confirmed by a court. Yes___
No ___

APPLICABLE ONLY TO CORPORATE ISSUERS

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As of September 30, 2005, there were 77,156,341 shares of Common Stock issued and outstanding.

Transitional Small Business Disclosure Format : Yes No X
 ----- -----

TIDELANDS OIL & GAS CORPORATION
FORM 10-QSB

INDEX

| | Page |
|--|-------|
| | ---- |
| PART I - Financial Information | |
| Item 1 - Financial Statements | |
| Condensed Consolidated Balance Sheets as of September 30, 2005 and December 31, 2004..... | 3 |
| Condensed Consolidated Statements of Operations For the Three Months Ended September 30, 2005 and 2004..... | 4 |
| Condensed Consolidated Statements of Operations For the Nine Months Ended September 30, 2005 and 2004..... | 5 |
| Condensed Consolidated Statements of Cash Flows For the Nine Months Ended September 30, 2005 and 2004..... | 6-7 |
| Notes to Condensed Consolidated Financial Statements..... | 8-13 |
| Item 2 - Management's Discussion and Analysis or Plan of Operation..... | 14-20 |
| Item 3 - Controls and Procedures..... | 20-21 |
| PART II - Other Information | |
| Item 1 - Legal Proceedings..... | 21-24 |
| Item 2 - Changes in Securities and Use of Proceeds..... | 24 |
| Item 3 - Defaults Upon Senior Securities..... | 25 |
| Item 4 - Submission of Matters to a Vote of Security Holdings..... | 25 |
| Item 5 - Other Information..... | 25 |
| Item 6 - Exhibits and Reports on Form 8K | 26 |
| Signature..... | 27 |

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

TIDELANDS OIL & GAS CORPORATION CONDENSED CONSOLIDATED BALANCE SHEETS

| | September 30, 2005 | December 31, 2004 |
|---|-----------------------|----------------------|
| | ----- (Unaudited) | ----- |
| (ASSETS) | | |
| ----- | | |
| Current Assets: | | |
| Cash | \$ 2,336,430 | \$ 5,459,054 |
| Cash Restricted | 101,471 | 25,000 |
| Accounts and Loans Receivable | 208,668 | 516,387 |
| Inventory | 90,332 | 82,523 |
| Prepaid Expenses | 208,879 | 487,488 |
| | ----- | ----- |
| Total Current Assets | 2,945,780 | 6,570,452 |
| | ----- | ----- |
| Property Plant and Equipment, Net | 10,097,779 | 9,086,313 |
| | ----- | ----- |
| Other Assets: | | |
| Deposits | 6,708 | 4,108 |
| Deferred Charges | 0 | 116,250 |
| Note Receivable | 284,944 | 286,606 |
| Goodwill | 1,158,937 | 1,158,937 |
| | ----- | ----- |
| Total Other Assets | 1,450,589 | 1,565,901 |
| | ----- | ----- |
| Total Assets | \$ 14,494,148 | \$ 17,222,666 |
| | ===== | ===== |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| ----- | | |
| Current Liabilities: | | |
| Accounts Payable and Accrued Expenses | \$ 642,457 | \$ 574,224 |
| Convertible Debentures Payable | 980,000 | 0 |
| | ----- | ----- |
| Total Current Liabilities | 1,622,457 | 574,224 |
| Long-Term Debt | 4,421,054 | 11,731,883 |
| | ----- | ----- |
| Total Liabilities | 6,043,511 | 12,306,107 |
| | ----- | ----- |
| Commitments and Contingencies | -- | -- |
| Stockholders' Equity: | | |
| Common Stock, \$.001 Par Value Per Share, 100,000,000 Shares Authorized, 77,156,341 and 61,603,359 Shares Issued and Outstanding at September 30, 2005 | | |

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| | | |
|--|---------------|---------------|
| and December 31, 2004 Respectively | 77,157 | 61,604 |
| Paid-in Capital in Excess of Par Value | 30,369,493 | 22,537,340 |
| Subscriptions Receivable | (550,000) | (550,000) |
| Accumulated (Deficit) | (21,446,013) | (17,132,385) |
| | ----- | ----- |
| Total Stockholders' Equity | 8,450,637 | 4,916,559 |
| | ----- | ----- |
| Total Liabilities and Stockholders' Equity | \$ 14,494,148 | \$ 17,222,666 |
| | ===== | ===== |

See Accompanying Notes to Condensed Consolidated Financial Statements

-3-

TIDELANDS OIL & GAS CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

| | Three Months Ended September 30, 2005 | Three Months Ended September 30, 2004 |
|---|--|--|
| | ----- | ----- |
| Revenues: | | |
| Gas Sales and Pipeline Fees | \$ 248,015 | \$ 824,848 |
| Construction Services | 0 | 0 |
| | ----- | ----- |
| Total Revenues | 248,015 | 824,848 |
| | ----- | ----- |
| Expenses: | | |
| Cost of Sales | 219,865 | 801,698 |
| Operating Expenses | 81,408 | 15,800 |
| Depreciation | 124,422 | 88,611 |
| Interest | 110,090 | 100,981 |
| Sales, General and Administrative | 923,701 | 1,130,918 |
| | ----- | ----- |
| Total Expenses | 1,459,486 | 2,138,008 |
| | ----- | ----- |
| (Loss) From Operations | (1,211,471) | (1,313,160) |
| Interest and Dividend Income | 26,589 | 5,667 |
| Income - Litigation Settlement | 109,369 | 0 |
| | ----- | ----- |
| Net (Loss) | \$ (1,075,513) | \$ (1,307,493) |
| | ===== | ===== |
| Net (Loss) Per Common Share: | | |
| Basic and Diluted | \$ (0.01) | \$ (0.02) |
| | ===== | ===== |
| Weighted Average Number of Common Shares Outstanding | 75,717,742 | 54,778,647 |
| | ===== | ===== |

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See Accompanying Notes to Condensed Consolidated Financial Statements

-4-

TIDELANDS OIL & GAS CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

| | Nine Months Ended September 30, 2005 | Nine Months Ended September 30, 2004 |
|---|---|---|
| | ----- | ----- |
| Revenues: | | |
| Gas Sales and Pipeline Fees | \$ 1,097,505 | \$ 1,332,560 |
| Construction Services | 119,121 | 0 |
| | ----- | ----- |
| Total Revenues | 1,216,626 | 1,332,560 |
| | ----- | ----- |
| Expenses: | | |
| Cost of Sales | 635,113 | 1,299,518 |
| Operating Expenses | 210,545 | 18,416 |
| Depreciation | 360,817 | 136,529 |
| Interest | 503,950 | 149,418 |
| Sales, General and Administrative | 4,022,271 | 4,837,296 |
| | ----- | ----- |
| Total Expenses | 5,732,696 | 6,441,177 |
| | ----- | ----- |
| (Loss) From Operations | (4,516,070) | (5,108,617) |
| (Loss) on Sale of Asset | (3,167) | 0 |
| Interest and Dividend Income | 96,240 | 16,740 |
| Income Litigation Settlement | 109,369 | 0 |
| | ----- | ----- |
| Net (Loss) | \$ (4,313,628) | \$ (5,091,877) |
| | ===== | ===== |
| Net (Loss) Per Common Share: | | |
| Basic and Diluted | \$ (0.06) | \$ (0.10) |
| | ===== | ===== |
| Weighted Average Number of Common Shares Outstanding | 69,378,850 | 51,926,974 |
| | ===== | ===== |

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See Accompanying Notes to Condensed Consolidated Financial Statements

-5-

TIDELANDS OIL & GAS CORPORATION
 STATEMENTS OF CONDENSED CONSOLIDATED CASH FLOWS
 (UNAUDITED)

| | Nine Months Ended September 30, 2005 ----- | Nine Months Ended September 30, 2004 ----- |
|--|--|--|
| Cash Flows Provided (Required) By | | |
| Operating Activities: | | |
| Net (Loss) | \$ (4,313,628) | \$ (5,091,877) |
| Adjustments to Reconcile Net (Loss) to Net Cash Provided (Required) By Operating Activities: | | |
| Depreciation | 360,817 | 136,529 |
| Write-Off of Subscription Receivable | 0 | 18,000 |
| Loss on Disposal of Equipment | 3,167 | 0 |
| Return of Issued Stock - Litigation Settlement | (109,369) | 0 |
| Issuance of Common Stock: For Services Provided | 1,424,575 | 3,747,066 |
| Changes in: | | |
| Accounts Receivable | 307,719 | (39,662) |
| Inventory | (7,809) | 0 |
| Prepaid Expenses | 278,609 | (116,682) |
| Deferred Charges | 116,250 | (245,600) |
| Deposits | (2,600) | (308) |
| Accounts Payable and Accrued Expenses | 68,233 | (387,031) |
| | ----- | ----- |
| Net Cash (Required) | | |
| By Operating Activities | (1,874,036) | (1,979,565) |
| | ----- | ----- |
| Cash Flows Provided (Required) | | |
| By Investing Activities: | | |
| Increase in Investments | 0 | 98,629 |
| Acquisitions of Property, Plant and Equipment | (1,376,250) | (692,597) |
| Disposals of Equipment | 800 | 0 |
| | ----- | ----- |
| Net Cash (Required) | | |
| By Investing Activities | (1,375,450) | (593,968) |
| | ----- | ----- |

See Accompanying Notes to Condensed Consolidated Financial Statements

-6-

TIDELANDS OIL & GAS CORPORATION
STATEMENTS OF CONDENSED CONSOLIDATED CASH FLOWS
(CONTINUED)

(UNAUDITED)

| | Nine Months Ended September 30, 2005 ----- | Nine Months Ended September 30, 2004 ----- |
|---|--|--|
| Cash Flows Provided (Required) | | |
| by Financing Activities: | | |
| Proceeds from Issuance of Common Stock | 0 | 4,088,317 |
| Proceeds From Long-Term Loans | 201,671 | 0 |
| Repayment of Short-Term Loans | 0 | (100,000) |
| Repayment of Loan by Related Party | 1,662 | 0 |
| | ----- | ----- |
| Net Cash Provided by Financing Activities | 203,333 | 3,988,317 |
| | ----- | ----- |
| Net Increase (Decrease) in Cash | (3,046,153) | 1,414,784 |
| Cash at Beginning of Period | 5,484,054 | 894,457 |
| | ----- | ----- |
| Cash at End of Period | \$ 2,437,901 | \$ 2,309,241 |
| | ===== | ===== |
| Supplemental Disclosures of Cash Flow Information: | | |
| Cash Payments for Interest | \$ 307,319 | \$ 22,011 |
| | ----- | ----- |
| Cash Payments for Income Taxes | \$ 0 | \$ 0 |
| | ===== | ===== |
| Non-Cash Investing & Financing Activities: | | |
| Return of Issued Stock for Litigation Settlements | \$ (109,369) | \$ 0 |
| Issuance of Common Stock: | | |
| Operating Activities | 1,424,575 | 3,747,066 |
| Repayment of Note and Loan | 2,512,500 | 75,000 |
| Repayment of Convertible Debentures | 4,020,000 | 0 |
| Payment of Account Payable | 0 | 38,311 |

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| | | |
|--|--------------|---------------|
| Acquisition of Property, Plant, Equipment and Goodwill for Note Payable | 0 | 6,523,773 |
| Prepayment of Legal Fees | 0 | 86,000 |
| | ----- | ----- |
| Total Non-Cash Financing Activities | \$ 7,847,706 | \$ 10,470,150 |
| | ===== | ===== |

See Accompanying Notes to Condensed Consolidated Financial Statements

-7-

TIDELANDS OIL & GAS CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2005

NOTE 1 - BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements for the nine month periods ended September 30, 2005 and 2004 have been prepared in conformity with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-QSB and Regulation S-B. The financial information as of December 31, 2004 is derived from the registrant's Form 10-KSB for the year ended December 31, 2004. Certain information or footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission.

The preparation of condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. In the opinion of management, the accompanying financial statements include all adjustments necessary (which are of a normal and recurring nature) for the fair presentation of the results of the interim periods presented. While the registrant believes that the disclosures presented are adequate to keep the information from being misleading, it is suggested that these accompanying financial statements be read in conjunction with the registrant's audited consolidated financial statements and notes for the year ended December 31, 2004, included in the registrant's Form 10-KSB for the year ended December 31, 2004.

Operating results for the nine-month periods ended September 30, 2005 are not necessarily indicative of the results that may be expected for the remainder of the fiscal year ending December 31, 2005. The accompanying unaudited condensed consolidated financial statements include the accounts of the registrant, its wholly-owned subsidiaries, Rio Bravo Energy, LLC, Sonora Pipeline, LLC, Arrecefe Management, LLC, Marea Associates, L.P., Reef Ventures, L.P., Reef International, LLC, Reef Marketing, LLC, and Terranova Energia S. de R. L. de C. V. All significant inter-company accounts and transactions have been

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eliminated in consolidation.

-8-

TIDELANDS OIL & GAS CORPORATION
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
 SEPTEMBER 30, 2005

NOTE 2 - LONG-TERM DEBT

A summary of long-term debt at September 30, 2005 and December 31, 2004 is as follows:

| | September 30, 2005 | December 31, 2004 |
|--|-----------------------|----------------------|
| | ----- | ----- |
| Note Payable, Secured, Interest Bearing at 2% Over Prime Rate, Maturing May 25, 2008 | \$ 4,421,054 | \$ 6,731,883 |
| Convertible Debentures, Unsecured, 7% Interest Bearing, Maturing May 17, 2006 | 980,000 | 5,000,000 |
| | ----- | ----- |
| | 5,401,054 | 11,731,883 |
| Less: Current Maturities | 980,000 | 0 |
| | ----- | ----- |
| Total Long-Term Debt | \$ 4,421,054 | \$ 11,731,883 |
| | ===== | ===== |

NOTE 3 - LITIGATION

On January 6, 2003, we were served as a third party defendant in a lawsuit titled Northern Natural Gas Company vs. Betty Lou Sheerin vs. Tidelands Oil & Gas Corporation, ZG Gathering, Ltd. and Ken Lay, in the 150th Judicial District Court, Bexar county, Texas, Cause Number 2002-C1-16421. The lawsuit was initiated by Northern Natural Gas when it sued Betty Lou Sheerin for her failure to make payments on a note she executed payable to Northern in the original principal amount of \$1,950,000. Northern's suit was filed on November 13, 2002. Sheerin answered Northern's lawsuit on January 6, 2003. Sheerin's answer generally denied Northern's claims and raised the affirmative defenses of fraudulent inducement by Northern, estoppel, waiver and the further claim that the note does not comport with the legal requirements of a negotiable instrument. Sheerin seeks a judicial ruling that Northern be denied any recovery on the note. Sheerin's answer included a counterclaim against Northern, ZG Gathering, and Ken Lay generally alleging, among other things, that Northern, ZG Gathering, Ltd. and Ken

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Lay, fraudulently induced her execution of the note. Northern has filed a general denial of Sheerin's counterclaims. Sheerin's answer included a third party cross claim against Tidelands. She alleges that Tidelands entered into an agreement to purchase the Zavala Gathering System from ZG Gathering Ltd. and that, as a part of the agreement, Tidelands agreed to satisfy all of the obligations due and owing to Northern, thereby relieving Sheerin of all obligations she had to Northern on the \$1,950,000 promissory note in question. Tidelands and Sheerin agreed to delay the Tidelands' answer date in order to allow time for mediation of the case. Tidelands participated in a mediation on March 11, 2003. The case was not settled at that time. Tidelands answered the Sheerin suit on March 26, 2003. Tidelands' answer denies all of Sheerin's allegations.

-9-

TIDELANDS OIL & GAS CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2005

NOTE 3 - LITIGATION (CONTINUED)

On May 24 and June 16, 2004 respectively, Betty Lou Sheerin filed her first and second amended original answer, affirmative defenses, special exceptions and second amended original counterclaim, second amended original third party cross-actions and requests for disclosure. In these amended pleadings, she sued Michael Ward, Royis Ward, James B. Smith, Carl Hessel and Ahmed Karim in their individual capacities. Her claims against these individuals are for fraud, breach of contract, breach of the Uniform Commercial Code, breach of duty of good faith and fair dealing and conversion. Sheerin has now non-suited her claims against Michael Ward, Royis Ward, and James B. Smith.

In September 2002, as a pre-closing deposit to the purchase of the ZG pipelines, the Company executed a \$300,000 promissory note to Betty L. Sheerin, a partner of ZG Gathering, Ltd. In addition, the Company issued 1,000,000 shares of its common stock to various partners of ZG Gathering, Ltd. On December 3, 2003, Sheerin filed a separate lawsuit against Tidelands in the 150th District Court of Bexar County, Texas on this promissory note seeking a judgment against Tidelands for the principle amount of the note, plus interest. On December 29th, 2003, Tidelands answered this lawsuit denying liability on the note. On April 1, 2004, Tidelands filed a plea in abatement asking the court to dismiss or abate Sheerin's lawsuit on the \$300,000 promissory note as it was related to and its outcome was dependent on the outcome of the Sheerin third party cross action against Tidelands in Cause Number 2002-C1-16421. The Company believes that the promissory note and shares of common stock should be cancelled based upon the outcome of the litigation described above. Accordingly, our financial statements reflect this belief.

On September 15, 2004 and again on October 15, 2004 respectively, Sheerin amended her pleadings to include a third and fourth amended third party cross action against Tidelands adding a claim for the \$300,000 promissory note. In these amended pleadings, Sheerin also deleted her claims against Carl Hessel and Ahmed Karim.

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Sheerin seeks damages against Tidelands for indemnity for any sums found to be due from her to Northern Natural Gas Company, unspecified amounts of actual damages, statutory damages, unspecified amounts of exemplary damages, attorneys fees, costs of suit, and prejudgment and post judgment interest.

On August 5, 2005, Northern Natural Gas Company filed its Fourth Amended Original Petition which, for the first time, named Tidelands as a defendant to Northern. Northern seeks to impose liability on Tidelands for \$1,950,000 promissory note signed by McDay Energy Partners, Ltd. (the predecessor to ZG Gathering, Ltd.) and Sheerin and the \$1,700,000 promissory note signed by

-10-

TIDELANDS OIL & GAS CORPORATION NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS SEPTEMBER 30, 2005

NOTE 3 - LITIGATION (CONTINUED)

McDay only. Northern contends that Tidelands is alternatively liable to Northern for payment of both such promissory notes totaling \$3,709,914 plus interest because Northern is a third-party beneficiary under a December 3, 2001 purchase and sale agreement between ZG and Tidelands claiming that in such agreement Tidelands agreed to assume and satisfy all indebtedness due and owing Northern by Sheerin and ZG. Northern also claims that it is entitled to foreclosure of a lien on the gas gathering system and pipeline that was the subject of the promissory notes in question.

Some discovery has been completed at this time. Based on initial investigation, and discovery to date, Tidelands appears to have a number of potential defenses to the claims of Sheerin and Northern. Tidelands intends to aggressively defend the lawsuit. At this stage in the litigation, and in light of our continuing investigation and incomplete discovery, we cannot give a more definitive evaluation of the extent of Tidelands' liability exposure.

During April and May, 2005, three separate legal actions were initiated against Sonterra Energy Corporation (Sonterra), a wholly-owned subsidiary of the Company. Two of the actions concern claims made by developers against Sonterra for their failure to pay rent and easement use fees as a result of their asset purchase from Oneok Propane Distribution Company on November 1, 2004. The third action involves a claim made by a builder that Sonterra does not have a proper easement for the current use of certain property. The Company believes that the three actions filed are without merit and intend to vigorously defend itself. Litigation regarding these three actions are still in their early stages, therefore, potential financial impacts, if any, cannot be determined at this time.

NOTE 4 - COMMON STOCK TRANSACTIONS

On July 1, 2005, the Company issued 1,000,000 shares of its restricted common stock valued at \$307,500 pursuant to an employment contract with

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an officer of the Company.

On July 1, 2005, the Company issued 50,000 shares of its restricted common stock valued at \$15,375 pursuant to an employment contract with an officer of the Company.

On July 1, 2005, the Company issued 10,000 shares of its restricted common stock valued at \$3,075 to an officer of the Company.

-11-

TIDELANDS OIL & GAS CORPORATION NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS SEPTEMBER 30, 2005

NOTE 4 - COMMON STOCK TRANSACTIONS (CONTINUED)

On August 18, 2005, Tidelands settled the legal dispute with L. L. Capital Group, LLC whereby L. L. Capital Group, LLC canceled 285,000 shares of the 1,000,000 shares of the Company's restricted common stock which it had received for a one year consulting contract executed August 4, 2004. The 285,000 shares canceled were valued at \$109,369.

On July 5, 2005, September 19, 2005 and September 29, 2005, Mercator Momentum Fund III, L.P., Monarch Pointe Fund, Ltd (the "Funds") and Robinson Reed, Inc. (a managed account of the "Funds") notified the Company of their intent to convert portions of their remaining 7% convertible debentures into common stock which were converted as follows:

| Entity ----- | Amount ----- | Price/Share ----- | Number of Shares ----- |
|-----------------------------------|----------------------|----------------------|------------------------------|
| July 5, 2005 ----- | | | |
| Robinson Reed, Inc. | \$ 200,000 | \$0.76 | 263,158 |
| September 19, 2005 ----- | | | |
| Mercator Momentum Fund, L.P. | 92,000 | 0.70 | 131,429 |
| Mercator Momentum Fund III, L.P. | 60,000 | 0.70 | 85,714 |
| Monarch Pointe Fund, Ltd. | 196,000 | 0.70 | 280,000 |
| Robinson Reed, Inc. | 52,000 | 0.70 | 74,286 |
| September 29, 2005 ----- | | | |
| Mercator Momentum Fund, L.P. | 207,000 | 0.71 | 291,549 |
| Mercator Momentum Fund, III, L.P. | 144,000 | 0.71 | 202,817 |
| Mercator Momentum Fund, Ltd. | 459,000 | 0.71 | 646,479 |
| Robinson Reed, Inc. | 90,000 | 0.71 | 126,761 |
| Total | \$1,500,000 ===== | | \$2,102,193 ===== |

The "Funds" shares issued were all included in the Company's

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registration statement filed on Form SB-2 which was declared effective by the Securities & Exchange Commission on May 27, 2005.

NOTE 5 - CONVERTIBLE DEBENTURES

After taking into account all of the 7% convertible debentures converted during the current quarter, \$980,000 of principal amount remains. All of these remaining 7% convertible debentures were converted on November 2, 2005 at the "Ceiling Price" of \$0.76 per share.

-12-

TIDELANDS OIL & GAS CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2005

NOTE 6 - RELATED PARTY TRANSACTION

The Company executed an agreement in January 2004 with a related party to provide charter air transportation for its employees, customers and contractors to job sites and other business related destinations. A prepayment of \$300,000 5% interest bearing loan due in January 2007 was made by the Company regarding the transaction. The loan balance is credited by airtime charges at standard industry rates offset by interest charges computed on the average monthly balance. At September 30, 2005, the loan balance was \$284,944.

Item 2. Management's Discussion and Analysis or Plan of Operation

Item 2. Management's Discussion and Analysis or Plan of Operation

Business Overview

Our products and services are primarily focused on development and operation of transportation, processing, distribution and storage projects for natural gas and natural gas liquids in the northeastern states of Mexico (Chihuahua, Coahuila, Nuevo Leon and Tamaulipas) and the state of Texas in the United States of America.

We derive our revenue from transportation fees from delivery of natural gas to Conagas, the local distribution company in Piedras Negras, Coahuila, through the pipeline owned by Reef Ventures, L.P. and the sale of propane gas to residential customers through the assets owned by Sonterra Energy Corporation. This company also designs and constructs residential propane delivery systems for new residential developments in Central Texas. We derive revenue from this activity in two ways, the first being from construction revenue for yard lines and meter sets installed to a homeowner's lot, and the second being the sale of LPG gas to customers in the residential subdivisions.

With respect to our pipeline system owned by Reef Ventures, L.P., management is evaluating an expansion of the pipeline in Coahuila to serve new markets along the state highway No. 57 corridor to Monclova, Coahuila. We currently expect that this project will not be activated until the fourth quarter of 2005. The planned natural gas liquid line between Eagle Pass, Texas and Piedras Negras, Coahuila is being re-evaluated in light of new supply sources emerging in Texas and Mexico. We are evaluating the utility of the project as either a tolling business model for existing demand in Coahuila or as a merchant facility in a direct contract with the propane importation arm of PEMEX. We expect further development of the project to be announced by the fourth quarter of 2005.

Sonterra Energy Corporation, a wholly owned subsidiary of Tidelands entered into the residential propane distribution business on November 1, 2004 with its acquisition of 850 existing customers located in 15 subdivisions in the vicinity of Austin, Texas. Sonterra's existing and future market area includes several central Texas locations that do not have access to natural gas as a fuel for home heating and appliance usage. Current expansion of over 400 lots within the existing subdivisions is possible. Sonterra has also entered into a new agreement with the developer of Northshore on Lake Travis to expand the currently serviced lots by an additional 1,000 units. Up to 2,625 additional lots may be available for installation of residential propane delivery in developments currently in the planning stages in the nearly central Texas vicinity. Management is actively seeking new subdivision installation of propane

systems in the Central Texas and has recently identified 4 new subdivisions in the San Antonio/Austin Hill Country corridor as prospective for system installation.

Rio Bravo Energy, LLC was formed on August 10, 1998 to operate the Chittim Gas Processing Plant which was purchased in 1999 and was processing natural gas primarily from Conoco Oil's Sacatosa Field. In October 2002, the plant was shut down due to the declining economics associated with low volume operation of the

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plant. We plan to either reopen the plant in 2005 when adequate volumes of LPG feedstock from third parties makes plant operations economically attractive or sell the assets to a third party. As noted above, Rio Bravo Energy LLC owns a general partner interest in Marea Associates, L.P. and the minority interest in Terranova Energia, S. de R.L. de C.V.

Sonora Pipeline, LLC was formed in January 1998 to operate the Sonora pipeline network which has the capability of delivering adequate volumes of natural gas for economic operation of the Chittim Gas Processing Plant. The pipeline network consists of approximately 80 miles of gas pipeline. Presently, the line is not in use. The pipeline was acquired in conjunction with the Chittim Gas Processing Plant acquisition. When operational, it would generate revenue from transportation fees charged to third party gas producers shipping natural gas to the Chittim Gas Plant owned by Rio Bravo Energy LLC. Management is evaluating whether to sell or utilize these assets and a decision is expected by the fourth quarter of 2005.

Sonora Pipeline LLC will also own and operate the U.S. (Texas) pipeline segments to be constructed in connection with the Mexican pipeline, LNG regasification terminal and gas storage projects which will interconnect to the U.S. via two international pipeline crossings near McAllen, Texas. Management expects a filing with the Federal Energy Regulatory Commission in the fourth quarter of 2005 for permission to operate these new pipelines and the granting of presidential permits for the international crossings near Penitas and Progreso, Texas for delivery of natural gas into the state of Tamaulipas and the pipelines owned by our Mexican subsidiary, Terranova Energia S. de R.L. de C.V.

The Company is focusing on the development of infrastructure projects through its Mexican entity, Terranova Energia S.de R.L. de C.V., in the nation of the United Mexican States (Mexico).

Terranova Energia is focused on project development and implementation of a natural gas storage and transportation infrastructure to support the integration of Northeastern Mexico and South Texas and the related economic growth of the border regions.

Tidelands and Terranova Energia have hired project development advisors in the United States and Mexico. The Terranova Energia advisors include ALB Energia, Rich, Heather Muller, Abogados and Miriam Grunstein, Abogada. The Tidelands advisors include Netherland Sewell & Associates, CenterPoint Energy,

-15-

LLC, Mayer Brown Rowe & Maw, LLP, BNC Engineering, LLC, HSBC Securities, USA, Inc. and R.W. Beck, Inc.

The Terranova Energia project was inspired by the fact that PEMEX, the Mexican national oil company, needs to manage its natural gas production in the Burgos Basin and the CFE, the Mexican federal electricity commission, needs to support a natural gas policy which encourages reliability, flexibility and competitive pricing for natural gas in northern Mexico. The region's forecasted growth will require additional natural gas for power generation in the region.

Our project area is called the Northeast Hub. Our medium term goals, subject to a variety of factors, including, but not limited to, regulatory permitting, engineering design, financing, construction and operating agreements, are focused on the Brasil storage field and Terranova Energia pipeline.

The pipelines proposed are (A) the Occidente Section comprised of: (1)

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a pipeline from the Brasil Storage field to Nuevo Progreso, proposed international pipeline crossing into the U.S., (2) a pipeline from Brasil storage to Station 19 up to Arguelles which is another proposed international pipeline crossing into U.S.; and (B) the Oriente Section from the offshore regasification station to Norte Puerto Mezquital proceeding to the Brazil storage field. The Occidente Section will include approximately 323 kilometers of pipeline and the Oriente Section will contain approximately 149 kilometers of pipeline. Our long term goal includes the construction of the offshore LNG regasification station.

The proposed international pipeline crossings into South Texas are the Donna Station and Arguelles and VGP station. At the Donna station our potential interconnects into Texas are with TETCO, TGPL and Texas Gas Services. At the Arguelles and VGP station our potential interconnects are with HPL, Calpine and Kinder Morgan. The Terranova pipeline capacity is estimated at 1.2 BCFD (billion cubic feet per day).

The Terranova pipelines have been designed for 30 and 36 inch diameter with bi-directional flow. The pipeline from the proposed LNG regasification terminal to the Brasil field is a 36 inch diameter pipeline and from the Brasil field to Monterey and international crossings are 30 inch diameter pipelines.

We submitted the permits for the Terranova pipeline Occidente and Oriente sections to the CRE, the Mexican energy regulatory entity, on March 18, 2005 and they were accepted for full review on June 14, 2005.

The proposed underground natural gas storage facility will be located in the depleted reservoir at the B1 Horizon-Brasil Field and include above ground facilities. Our design proposal for the use of this depleted reservoir as a storage facility was prepared by Netherland Sewell. Netherland Sewell, after geological and mechanical modeling, reported the reservoir at the B1 horizon as suitable for natural gas storage. The design capacity of the storage field contemplates incremental increases in capacity over three seasons. The first

-16-

season capacity is 25 BCF (billion cubic feet), second season capacity is 40 BCF and third season onward is 50 BCF. The design proposes that natural gas be injected into the reservoir at 350 MMCFD (million cubic feet per day) at pressures from 2,400 psi up to 3,200 psi. Extraction flows of natural gas will be kept at 500 MMCFD to maintain structural integrity of the reservoir. The storage facility plans call for 22 injection and extraction wells. The above ground facilities will include compression stations.

We submitted the storage permit to the CRE on August 5, 2005 and it was accepted for full review on October 14, 2005.

The proposed Offshore LNG Regasification Station will be based on technology developed by the Norwegian company Remora Technology. It utilizes an unmanned floating station called a HiLoad. It has a peak capacity of 1.4 BCFD (billion cubic feet per day). This technology permits any LNG carrier vessel to connect and carry out regasification operations without any vessel modifications. It utilizes LNG vaporizers of the shell and tube type, with sea water as the heating medium. The LNG station will be located no less than 40 nautical miles from the coast at a depth of 450 feet. A support station with a power generation system and central control will be located on-shore. A buoy will support the mooring of the LNG carrier vessels. Electrical power cables, control umbilicals and pipelines will connect the HiLoad to the on-shore support station.

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There are significant challenges for the natural gas supply to the power generation industry in Northeastern Mexico. We believe the CFE has taken a proactive role in this region with a view to substantially improving the reliability, flexibility and pricing of the natural gas supply. Presently, there are three LNG regasification projects permitted in this region at Altamira, Rosarito and Manzanillo. Additionally, there new electrical generation plants and associated pipelines under construction. The CFE has forecasted natural gas demand growth in the region from 2004 through year 2013. The CFE forecasts gas demand will increase from 1.7 BCFD in 2004 to 4.2 BCFD in 2013. Natural gas storage facilities in northern Mexico will provide a reliable, flexible gas supplies while creating conditions for competitive natural gas pricing.

Forward Looking Statements:

We have included forward-looking statements in this report. For this purpose, any statements contained in this report that are not statements of historical fact may be deemed to be forward looking statements. Without limiting the foregoing, words such as "may", "will", "expect", "believe", "anticipate", "estimate", "plan" "propose" or "continue" or the negative or other variations thereof or comparable terminology are intended to identify forward-looking statements. These statements by their nature involve substantial risks and uncertainties, and actual results may differ materially depending on a variety of factors. Factors that might cause forward-looking statements to differ materially from actual results include, among other things, overall economic and business conditions, demand for the Company's products, competitive factors in

-17-

the industries in which we compete or intend to compete, natural gas availability and cost and timing, impact and other uncertainties of our future acquisition plans.

Results of Operations

REVENUES: The Company reported revenues of \$1,216,626 for the nine months ended September 30, 2005 as compared with revenues from continuing operations of \$1,332,560 for the nine months ended September 30, 2004. The revenue decrease occurred as a result of the conversion of the Reef Ventures, L.P. revenue stream from sale of natural gas to the collection of transportation fees only. Offsetting this decrease is the inclusion of sales of propane gas to the customers of Sonterra Energy Corporation, and this revenue source was not present in the revenue for the period ended September 30, 2004. Management expects that revenues from Reef Ventures, L.P. will increase substantially in the 2006 fiscal year due to anticipated increases in volumes of natural gas transported through the international pipeline crossing into Piedras Negras, Coahuila, MX.

TOTAL COSTS AND EXPENSES: Total costs and expenses from continuing operations decreased from \$6,441,177 for the nine months ended September 30, 2004 to \$5,732,696 for the nine months ended September 30, 2005.

COST OF SALES: Total Cost of Sales decreased from \$1,299,518 for the nine months ended September 30, 2004 to \$635,113 for the nine months ended September 30, 2005. This decrease resulted due to the change in operations of the Reef Ventures, L.P. pipeline from gas marketing to transportations fees as the operating model for this business segment. The entire cost of sales expense category now represents cost of propane and directly related expenses incurred by Sonterra Energy Corporation.

OPERATING EXPENSES: Operating expenses from continuing operations increased from

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\$18,416 for the nine months ended September 30, 2004 to \$210,545 for the nine months ended September 30, 2005. This increase was primarily due to additional operating expenses incurred by Sonterra Energy Corporation in its operations for the period which were not present in the comparative nine months for 2004. Depreciation expense increased by \$224,288 for the period ended September 30, 2005 versus the nine months ended September 30, 2004 due to additional depreciation related to the acquisition of the natural gas pipeline owned by Reef Ventures, L.P. and the depreciable assets acquired by Sonterra Energy Corporation for the operation of the residential propane distribution systems in Austin, Texas. Interest expense increased by \$354,532 during the nine months ended September 30, 2005 versus the nine months period ended September 30, 2004 due to the debt incurred to acquire the natural gas pipeline owned by Reef Ventures, L.P. and the issuance of convertible debt to entities associated with the Mercator Advisory Group, LLC, now known as MAG Capital, LLC.

SALES, GENERAL AND ADMINISTRATIVE: Sales, General & Administrative Expenses decreased by \$815,025 during the nine months ended September 30, 2005 as compared with the period ended September 30, 2004. Consulting fees decreased by

-18-

over \$2,630,000 for the comparative periods but were partially offset by increases in employee and director compensation of \$816,000, selling, general and administrative expenses from the new operations of Sonterra Energy Corporation in the amount of \$463,000, increased travel and entertainment of \$192,000, and increases in several other general and administrative cost categories aggregating approximately \$344,000.

NET LOSS FROM OPERATIONS: Net loss from operations of (\$5,108,617) for the nine months ended September 30, 2004 decreased to (\$4,516,070) for the nine months ended September 30, 2005, a decrease in the amount of loss of \$592,547. Included in the net loss from operations is \$1,424,575 of expenses for employee stock bonuses, director fees, financing costs, public relations fees, and legal fees paid by issuance of common stock.

LIQUIDITY AND CAPITAL RESOURCES: Direct capital expenditures during the nine months ended September 30, 2005 totaled \$1,376,250. The capital expenditures were composed of increased office furniture, equipment and leasehold costs plus pre-construction costs regarding potential international pipeline crossings and storage facilities in Mexico, and additional machinery, equipment, trucks, autos and trailers for the operation of the Sonterra Energy Corporation propane systems. Total debt decreased from \$12,306,107 at December 31, 2004 to \$6,043,511 at September 30, 2005. The decrease in total debt is due primarily to conversion of debentures to common stock in the amount of \$4,020,000 and the exercise of warrants which reduced an outstanding note payable in the amount of \$2,512,500. Net loss for the nine months ended September 30, 2005 was (\$4,313,628) a decrease in net loss of 15% from the net loss of (\$5,091,877) for the nine months ended September 30, 2004. Basic and diluted net loss per common share decreased 40% to (\$0.06). The net loss per share calculation for the nine months ended September 30, 2005 included an increase in actual and equivalent shares outstanding.

FORWARD-LOOKING STATEMENTS:

We have included forward-looking statements in this report. For this purpose, any statements contained in this report that are not statements of historical fact may be deemed to be forward looking statements. Without limiting the foregoing, words such as "may", "will", "expect", "believe", "anticipate", "estimate", "plan" or "continue" or the negative or other variations thereof or comparable terminology are intended to identify forward-looking statements.

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These statements by their nature involve substantial risks and uncertainties, and actual results may differ materially depending on a variety of factors. Factors that might cause forward-looking statements to differ materially from actual results include, among other things, overall economic and business conditions, demand for the Company's products, competitive factors in the industries in which we compete or intend to compete, natural gas availability and cost and timing, impact and other uncertainties of our future acquisition plans.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK:

The Company does not issue or invest in financial instruments or their derivatives for trading or speculative purposes. The operations of the Company are conducted primarily in the United States, and, are not subject to material

-19-

foreign currency exchange risk. Although the Company has outstanding debt and related interest expense, market risk of interest rate exposure in the United States is currently not material.

Item 3. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures.

As of the end of the reporting period, September 30, 2005, we carried out an evaluation, under the supervision and with the participation of our management, including the Company's Chairman and Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15(e) of the Securities Exchange Act of 1934 (the "Exchange Act"), which disclosure controls and procedures are designed to insure that information required to be disclosed by a company in the reports that it files under the Exchange Act is recorded, processed, summarized and reported within required time periods specified by the SEC's rules and forms. Based upon that evaluation, the Chairman and the Chief Financial Officer concluded that our disclosure controls and procedures are effective in timely alerting them to material information relating to the Company required to be included in the Company's period SEC filings.

(b) Changes in Internal Control.

Subsequent to the date of such evaluation as described in subparagraph(a)above, there were no changes in our internal controls or other factors that could significantly affect these controls, including any corrective action with regard to significant deficiencies and material weaknesses.

(c) Limitations.

Our management, including our Principal Executive Officer and Principal Financial Officer, does not expect that our disclosure controls or internal controls over financial reporting will prevent all errors or all instances of fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within our company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple

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error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and any design may not succeed in achieving its stated goals under all potential future conditions.

-20-

Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures. Because of the inherent limitation of a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

Matter No. 1:

On January 6, 2003, we were served as a third party defendant in a lawsuit titled Northern Natural Gas Company vs. Betty Lou Sheerin vs. Tidelands Oil & Gas Corporation, ZG Gathering, Ltd. and Ken Lay, in the 150th Judicial District Court, Bexar County, Texas, Cause Number 2002-C1-16421. The lawsuit was initiated by Northern Natural Gas when it sued Betty Lou Sheerin for her failure to make payments on a note she executed payable to Northern in the original principal amount of \$1,950,000. Northern's suit was filed on November 13, 2002. Sheerin answered Northern's lawsuit on January 6, 2003. Sheerin's answer generally denied Northern's claims and raised the affirmative defenses of fraudulent inducement by Northern, estoppel, waiver and the further claim that the note does not comport with the legal requirements of a negotiable instrument. Sheerin seeks a judicial ruling that Northern be denied any recovery on the note. Sheerin's answer included a counterclaim against Northern, ZG Gathering, and Ken Lay generally alleging, among other things, that Northern, ZG Gathering, Ltd. and Ken Lay, fraudulently induced her execution of the note. Northern has filed a general denial of Sheerin's counterclaims. Sheerin's answer included a third party cross claim against Tidelands. She alleges that Tidelands entered into an agreement to purchase the Zavala Gathering System from ZG Gathering Ltd. and that, as a part of the agreement, Tidelands agreed to satisfy all of the obligations due and owing to Northern, thereby relieving Sheerin of all obligations she had to Northern on the \$1,950,000 promissory note in question. Tidelands and Sheerin agreed to delay the Tidelands' answer date in order to allow time for mediation of the case. Tidelands participated in mediation on March 11, 2003. The case was not settled at that time. Tidelands answered the Sheerin suit on March 26, 2003. Tidelands' answer denies all of Sheerin's allegations.

On May 24 and June 16, 2004 respectively, Betty Lou Sheerin filed her first and second amended original answer, affirmative defenses, special exceptions and second amended original counterclaim, second amended original third party cross-actions and requests for disclosure. In these amended pleadings, she sued Michael Ward, Royis Ward, James B. Smith, Carl Hessel and Ahmed Karim in their individual capacities. Her claims against these individuals are for fraud, breach of contract, breach of the Uniform Commercial Code, breach of duty of good faith and fair dealing and conversion. Sheerin has now non-suited her claims against Michael Ward, Royis Ward, and James B. Smith.

-21-

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In September 2002, as a pre-closing deposit to the purchase of the ZG pipelines, the Company executed a \$300,000 promissory note to Betty L. Sheerin, a partner of ZG Gathering, Ltd. In addition, the Company issued 1,000,000 shares of its common stock to various partners of ZG Gathering, Ltd. On December 3, 2003, Sheerin filed a separate lawsuit against Tidelands in the 150th District Court of Bexar County, Texas on this promissory note seeking a judgment against Tidelands for the principle amount of the note, plus interest. On December 29th, 2003, Tidelands answered this lawsuit denying liability on the note. On April 1, 2004, Tidelands filed a plea in abatement asking the court to dismiss or abate Sheerin's lawsuit on the \$300,000 promissory note as it was related to and its outcome was dependent on the outcome of the Sheerin third party cross action against Tidelands in Cause Number 2002-C1-16421. The company believes that the promissory note and shares of common stock should be cancelled based upon the outcome of the litigation described above. Accordingly, our financial statements reflect this belief.

On September 15, 2004 and again on October 15, 2004 respectively, Sheerin amended her pleadings to include a third and fourth amended third party cross action against Tidelands adding a claim for the \$300,000 promissory note. In these amended pleadings, Sheerin also deleted her claims against Carl Hessel and Ahmed Karim. After adding the claim on the \$300,000 promissory note to the third party claims of Sheerin against Tidelands in Cause No. 2002-C1-16421, Sheerin dismissed Cause Number 2002-C1-16421.

Sheerin seeks damages against Tidelands for indemnity for any sums found to be due from her to Northern Natural Gas Company, unspecified amounts of actual damages, statutory damages, unspecified amounts of exemplary damages, attorneys fees, costs of suit, and prejudgment and post judgment interest.

On August 5, 2005, Northern Natural Gas Company filed its Fourth Amended Original Petition which, for the first time, named Tidelands as a defendant to Northern. Northern seeks to impose liability on Tidelands for \$1,950,000 promissory note signed by McDay Energy Partners, Ltd. (the predecessor to ZG Gathering, Ltd.) and Sheerin and the \$1,700,000 promissory note signed by McDay only. Northern contends that Tidelands is alternatively liable to Northern for payment of both such promissory notes totaling \$3,709,914 plus interest because Northern is a third party beneficiary under a December 3, 2001 purchase and sale agreement between ZG and Tidelands claiming that in such agreement Tidelands agreed to assume and satisfy all indebtedness due and owing Northern by Sheerin and ZG. Northern also claims that it is entitled to foreclosure of a lien on the gas gathering system and pipeline that was the subject of the promissory notes in question.

Some discovery has been completed at this time. Based on initial investigation, and discovery to date, Tidelands appears to have a number of potential defenses to the claims of Sheerin and Northern. Tidelands intends to aggressively defend these lawsuits. At this stage in the litigation, and in

-22-

light of our continuing investigation and incomplete discovery, we cannot give a more definitive evaluation of the extent of Tidelands' liability exposure.

Matter No. 2:

On May 4, 2005, HBH Development Company, LLC initiated legal action against Sonterra Energy Corporation in the District Court of Travis County, Texas, 98th Judicial District. This action involves the developer of the Austin's Colony Subdivision in Travis County, Texas and the propane distribution system originally constructed by Southern Union Company. Southern Union entered

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into a letter agreement with HBH concerning the construction and operation of a propane distribution system in the subdivision to be owned and operated by Southern Union. Southern Union assigned the letter agreement and its interests in the propane system to Oneok, Inc., the parent company of Oneok Propane Company. Sonterra acquired its interest in the propane system from Oneok Propane Distribution Company. HBH is claiming that Sonterra has failed or refused to pay HBH rent and easement use fees under the terms of the letter agreement. HBH alleges that Sonterra's actions cause a failure of the assignment whereby it acquired rights in the propane system or alternatively, if the assignment is effective, for breach of contract. HBH seeks to have the court terminate Sonterra's rights in the propane distribution system, award unspecified monetary damages, cancellation of the contract and rights associated with the propane distribution system, issue to HBH a writ of possession for the property, and for attorneys fees.

Sonterra is defending the legal action. It believes that under the terms of the letter agreement between HBH Development Company and Southern Union Company, that the easement use fees terminated when Southern Union conveyed its interest in the propane distribution system to Oneok Propane Company.

Matter No. 3:

On May 4, 2005, Senna Hills, Ltd. initiated legal action against Sonterra Energy Corporation in the District Court of Travis County, Texas, 53rd Judicial District. This action involves the developer of the Senna Hills Subdivision in Travis County, Texas and the propane distribution system originally constructed by Southern Union Company. Southern Union entered into a letter agreement with Senna Hills concerning the construction and operation of a propane distribution system in the subdivision to be owned and operated by Southern Union. Southern Union assigned the letter agreement and its interests in the propane system to Oneok, Inc., the parent company of Oneok Propane Company. Sonterra acquired its interest in the propane system from Oneok Propane Distribution Company. Senna Hills is claiming that Sonterra has failed or refused to pay Senna Hills rent and easement use fees under the terms of the letter agreement. Senna Hills alleges that Sonterra's actions cause a failure of the assignment whereby it acquired rights in the propane system or alternatively, if the assignment is effective, for breach of contract. Senna Hills seeks to have the court terminate Sonterra's rights in the propane distribution system, award unspecified monetary damages, and cancellation of the

-23-

contract and rights associated with the propane distribution system, issue to Senna Hills a writ of possession for the property, and attorneys fees.

Senna Hills sold certain undeveloped sections of Senna Hills Subdivision to a new owner. Sonterra believes that it has the right to expand its distribution system into such undeveloped sections of the subdivision. Sonterra plans to expand the distribution system into these sections under an agreement with the new owner. Senna Hills has stated that although it is not presently objecting to Sonterra's expansion of the system at this time, it is reserving its claim that Sonterra does not have the right to do so and that it intends to ask the court to cancel Sonterra's right to use and possession of the propane distribution system, including the system in the new sections of the subdivision.

Sonterra is defending the legal action. It believes that under the terms of the letter agreement between Senna Hills and Southern Union Company, that the easement use fees terminated when Southern Union conveyed its interest in the propane distribution system to Oneok Propane Company.

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Matter No. 4:

On April of 2005, Goodson Builders, Ltd. named Sonterra Energy Corporation in a legal action titled, Goodson Builders, Ltd, Plaintiff vs. Jim Blackwell and BNC Engineering, LLC, Defendants. The legal action is in the District Court of Travis County, Texas 345th Judicial District. This legal action arises from a claim that an underground propane storage tank and underground distribution lines is situated on the Plaintiff's lot in the Hills of Lakeway subdivision, Travis County, Texas. Plaintiff alleges that there is no recorded easement setting forth the rights and obligations of the parties for use of the propane tank and lines. However, there is reference to a "suburban propane easement" on the plat document. Plaintiff alleges that the property is being used without permission and the use constitutes an on-going trespass. Plaintiff asks the court to determine that his lot is not subject to a "suburban propane easement", declare the propane equipment the property of plaintiff, enjoin Sonterra from use of Plaintiff's land, and award damages. The Plaintiff seeks damages of \$165,000 based on a market rental rate he claims to be \$5,000 per month, \$50,000 damages for depreciation of the value of the lot, an unspecified amount of exemplary damages, and attorneys' fees. Sonterra is defending the claims.

Matter No. 5:

On August 18, 2005, Tidelands settled the legal dispute with L.L. Capital Group, LLC. Tidelands and L.L. Capital Group agreed to cancel 285,000 shares of the 1,000,000 share consulting fee. L.L. Capital Group, LLC retained 715,000 shares.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

On July 1, 2005, we issued 10,000 common shares to Jason Jones, a Sonterra Energy employee for services rendered valued at \$3,075.00.

-24-

On July 1, 2005, we issued Robert Dowies, a company employee, 50,000 common shares associated with his employment agreement. The shares were valued at \$15,375.

On July 1, 2005, we issued Michael Ward, our company President and CEO, 1,000,000 common shares associated with his employment contract. The shares were valued at \$307,500.

We relied on Section 4(2) as the securities transaction exemption afforded by the Securities Act of 1933, as amended.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

No matter was submitted to a vote of the security holders, through the solicitation of proxies or otherwise, during the quarter of the fiscal year covered by this report.

Item 5. Other Information

During the third quarter the Mercator group of companies, converted the following debentures into common stock:

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July 5 Conversion:

- o Robinson Reed converted \$200,000 of the 7% Convertible Debentures into common shares at \$0.76 per share.

September 19 Conversions:

- o Robinson Reed converted \$52,000 of the 7% Convertible Debentures into 74,286 common shares at \$0.70 per share.
- o Monarch Pointe Fund converted \$196,000 of the 7% Convertible Debentures into 280,000 common shares at \$0.70 per share.
- o Mercator Momentum Fund, LP converted \$92,000 of the 7% Convertible Debentures into 131,429 common shares at \$0.70 per share.
- o Mercator Momentum Fund III converted \$60,000 of the 7% Convertible Debentures into 85,714 common shares at \$0.70 per share.

September 29 Conversions:

- o Robinson Reed converted \$90,000 of the 7% Convertible Debentures into 126,761 common shares at \$0.71 per share.
- o Monarch Pointe Fund converted \$459,000 of the 7% Convertible Debentures into 646,479 common shares at \$0.71 per share.

-25-

- o Mercator Momentum Fund, LP converted \$207,000 of the 7% Convertible Debentures into 291,549 common shares at \$0.71 per share.
- o Mercator Momentum Fund III converted \$144,000 of the 7% Convertible Debentures into 202,817 common shares at \$0.71 per share.

On November 2, 2005, the Mercator group of companies converted the balance of the outstanding 7% Convertible Debentures into common stock as follows:

- o Robinson Reed converted \$158,000 of the 7% Convertible Debentures into 207,895 common shares at the "Ceiling Price" of \$0.76 per share.
- o Monarch Pointe Fund converted \$473,100 of the 7% Convertible Debentures into 622,500 common shares at the "Ceiling Price" of \$0.76 per share.
- o Mercator Momentum Fund, LP converted \$214,000 of the 7% Convertible Debentures into 281,579 common shares at the "Ceiling Price" of \$0.76 per share.
- o Mercator Momentum Fund III converted \$134,900 of the 7% Convertible Debentures into 177,500 common shares at the "Ceiling Price" of \$0.76 per share.

Item 6. Exhibits

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a) Exhibits

| Exhibit No. | Exhibit Name |
|-------------|---|
| 31.1 | Chief Executive Officer-Section 302 Certification pursuant to Sarbanes-Oxley Act. |
| 31.2 | Chief Financial Officer- Section 302 Certification pursuant to Sarbanes-Oxley Act. |
| 32.1 | Chief Executive and Financial Officer-Section 906 Certification pursuant to Sarbanes-Oxley Act. |

-26-

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

TIDELANDS OIL & GAS CORP.

Dated: November 14, 2005

By: /s/ Michael Ward

Michael Ward
Title: President, CEO

Dated: November 14, 2005

By: /s/ James B. Smith

James B. Smith
Title: CFO

-27-