

Midwest Energy Emissions Corp.  
Form 10-Q  
August 08, 2016

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, DC 20549**

**FORM 10-Q**

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

For the quarterly period ended **June 30, 2016**

Commission file number **000-33067**

**MIDWEST ENERGY EMISSIONS  
CORP.**

(Exact name of Registrant as Specified in its Charter)

**Delaware**  
(State or other jurisdiction  
of incorporation or organization)

**87-0398271**  
(I.R.S. Employer  
Identification No.)

**670 D Enterprise Drive**

**Lewis Center, Ohio**  
(Address of principal Executive offices)

**43035**  
(Zip Code)

**(614) 505-6115**

Edgar Filing: Midwest Energy Emissions Corp. - Form 10-Q

(Registrant's Telephone Number, Including Area Code)

---

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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

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

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

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input checked="" type="checkbox"/>

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

State the number of shares outstanding of each of the Issuer's classes of common stock, as of the latest practicable date: Common, \$.001 par value per share; 47,523,118 outstanding as of August 8, 2016.

**MIDWEST ENERGY EMISSIONS CORP.**

**TABLE OF CONTENTS**

	<b>Page</b>
<b><u>PART I – FINANCIAL INFORMATION</u></b>	
<u>Item 1. Condensed Consolidated Financial Statements.</u>	4
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.</u>	30
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk.</u>	38
<u>Item 4. Controls and Procedures.</u>	38
<b><u>PART II – OTHER INFORMATION</u></b>	
<u>Item 1. Legal Proceedings.</u>	39
<u>Item 1A. Risk Factors</u>	39
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.</u>	39
<u>Item 3. Default upon Senior Securities.</u>	39
<u>Item 4. Mine Safety Disclosure.</u>	39
<u>Item 5. Other Information.</u>	39
<u>Item 6. Exhibits.</u>	40
<b><u>SIGNATURES</u></b>	<b>41</b>

## **PART I – FINANCIAL INFORMATION**

### **Forward-Looking Statements**

*This Quarterly Report on Form 10-Q contains "forward-looking statements," as defined in Section 21E of the Securities Exchange Act of 1934, as amended, that are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 and reflect our current expectations regarding our future growth, results of operations, cash flows, performance and business prospects, and opportunities, as well as assumptions made by, and information currently available to, our management. Forward-looking statements are generally identified by using words such as "anticipate," "believe," "plan," "expect," "intend," "will," and similar expressions, but these words are not the exclusive means of identifying forward-looking statements. Forward-looking statements in this report are subject to risks and uncertainties that could cause actual events or results to differ materially from those expressed in or implied by the statements. These statements are based on information currently available to us and are subject to various risks, uncertainties, and other factors, including, but not limited to, those discussed under the caption "Risk Factors" in the Company's 2015 Form 10-K. In addition, matters that may cause actual results to differ materially from those in the forward-looking statements include, among other factors, the gain or loss of a major customer, change in environmental regulations, disruption in supply of materials, capacity factor fluctuations of power plant operations and power demands, a significant change in general economic conditions in any of the regions where our customer utilities might experience significant changes in electric demand, a significant disruption in the supply of coal to our customer units, the loss of key management personnel, availability of capital and any major litigation regarding the Company. Except as expressly required by the federal securities laws, we undertake no obligation to update such factors or to publicly announce the results of any of the forward-looking statements contained herein to reflect future events, developments, or changed circumstances or for any other reason.*

Table of Contents

**ITEM 1 – FINANCIAL INFORMATION**

**MIDWEST ENERGY EMISSIONS CORP. AND SUBSIDIARIES**

Index to Condensed Consolidated Financial Information

As of the and for the six months ended June 30, 2016

	<b>Page</b>
<u>Condensed Consolidated Balance Sheets</u>	5
<u>Condensed Consolidated Statements of Operations</u>	6
<u>Condensed Consolidated Statements of Stockholders' Deficit</u>	7
<u>Condensed Consolidated Statements of Cash Flows</u>	8
<u>Notes to Condensed Consolidated Financial Statements</u>	9

## MIDWEST ENERGY EMISSIONS CORP AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS

JUNE 30, 2016 AND DECEMBER 31, 2015

(UNAUDITED)

	<b>June 30,</b>	
	<b>2016</b>	
	<b>(Unaudited)</b>	<b>December 31,</b>
		<b>2015</b>
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 619,064	\$ 1,083,280
Accounts receivable	4,039,784	1,150,602
Inventory	877,767	2,715,913
Prepaid expenses and other assets	167,848	161,813
<b>Total current assets</b>	<b>5,704,463</b>	<b>5,111,608</b>
Property and equipment, net	2,066,881	1,243,450
License, net	55,883	58,825
Prepaid expenses and other assets	-	4,058
Customer acquisition costs, net	883,895	897,428
<b>Total assets</b>	<b>\$ 8,711,122</b>	<b>\$ 7,315,369</b>

## LIABILITIES AND STOCKHOLDERS' DEFICIT

<b>Current liabilities</b>		
Accounts payable and accrued expenses	\$ 4,298,536	\$ 1,235,162
Deferred revenue	39,832	2,281,760
Convertible notes payable	4,041,935	2,497,114
Current portion of equipment notes payable	38,593	20,979
Customer credits	936,500	936,500
<b>Total current liabilities</b>	<b>9,355,396</b>	<b>6,971,515</b>
Convertible notes payable, net of discount	3,349,850	3,175,085
Warrant liability	15,207,000	9,854,400
Accrued interest	229,066	169,202
Equipment notes payable	163,114	90,165
<b>Total liabilities</b>	<b>28,304,426</b>	<b>20,260,367</b>
<b>Stockholders' deficit</b>		

Edgar Filing: Midwest Energy Emissions Corp. - Form 10-Q

Preferred stock, \$.001 par value: 2,000,000 shares authorized	-	-
Common stock; \$.001 par value; 150,000,000 shares authorized; 47,358,618 shares issued and outstanding as of June 30, 2016		
47,194,118 shares issued and outstanding as of December 31, 2015	47,359	47,194
Additional paid-in capital	25,694,063	25,008,016
Accumulated deficit	(45,334,726)	(38,000,208)
<b>Total stockholders' deficit</b>	<b>(19,593,304)</b>	<b>(12,944,998)</b>
<b>Total liabilities and stockholders' deficit</b>	<b>\$ 8,711,122</b>	<b>\$ 7,315,369</b>

*The accompanying notes are an integral part of these condensed consolidated financial statements.*

Table of Contents

**MIDWEST ENERGY EMISSIONS CORP AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2016 AND 2015**  
**(UNAUDITED)**

	<b>For the Three Months Ended June 30, 2016</b>	<b>For the Three Months Ended June 30, 2015</b>	<b>For the Six Months Ended June 30, 2016</b>	<b>For the Six Months Ended June 30, 2015</b>
<b>Revenues</b>	9,392,209	2,696,685	12,765,520	2,940,029
<b>Costs and expenses:</b>	-			
Cost of sales	7,304,197	2,334,219	9,791,816	2,840,962
Selling, general and administrative expenses	1,667,827	1,052,691	2,837,985	2,035,423
<b>Total costs and expenses</b>	8,972,024	3,386,910	12,629,801	4,876,385
<b>Operating income (loss)</b>	420,185	(690,225)	135,719	(1,936,356)
<b>Other (expense) income</b>				
Interest expense	(1,032,949)	(936,116)	(3,106,093)	(4,358,472)
Letter of credit fees	(60,666)	-	(103,333)	-
Change in value of warrant liability	(7,566,000)	3,195,279	(4,256,600)	1,316,729
Debt conversion costs	-	(961,843)	-	(961,843)
State income taxes	(3,383)	(7,730)	(4,211)	(28,225)
<b>Total other (expense) income</b>	(8,662,998)	1,289,590	(7,470,237)	(4,031,811)
<b>Net (loss) income</b>	\$ (8,242,813)	\$ 599,365	\$ (7,334,518)	\$ (5,968,167)
<b>Net (loss) income per common share - basic and diluted:</b>	\$ (0.17)	\$ 0.01	\$ (0.15)	\$ (0.15)
<b>Weighted average common shares outstanding</b>	47,358,618	41,322,566	47,358,618	41,124,352



*The accompanying notes are an integral part of these condensed consolidated financial statements.*

Table of Contents

**MIDWEST ENERGY EMISSIONS CORP AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIT**  
**FOR THE SIX MONTHS ENDED JUNE 30, 2016**  
**(UNAUDITED)**

	Common Stock Shares	Par Value	Additional Paid-in Capital	Accumulated (Deficit)	Total Stockholders' Deficit
<b>Balance - December 31, 2015</b>	47,194,118	\$ 47,194	\$ 25,008,016	\$ (38,000,208)	\$ (12,944,998)
Stock issued for interest on notes payable	164,500	165	103,470	-	103,635
Issuance of stock options	-	-	582,577	-	582,577
Net loss for the period	-	-	-	(7,334,518)	(7,334,518)
<b>Balance - June 30, 2016</b>	47,358,618	\$ 47,359	\$ 25,694,063	\$ (45,334,726)	\$ (19,593,304)

*The accompanying notes are an integral part of these condensed consolidated financial statements.*

Table of Contents

**MIDWEST ENERGY EMISSIONS CORP AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOW**  
**FOR THE SIX MONTHS ENDED JUNE 30, 2016 AND 2015**  
**(UNAUDITED)**

	<b>For the Six Months Ended June 30, 2016</b>	<b>For the Six Months Ended June 30, 2015</b>
<b>Cash flows from operating activities</b>		
Net loss	\$ (7,334,518)	\$ (5,968,167)
<b>Adjustments to reconcile net loss to net cash provided by (used in) operating activities:</b>		
Stock based compensation	582,577	331,189
Amortization of license fees	2,942	2,942
Amortization of discount of notes payable	851,735	3,192,741
Amortization of debt issuance costs	334,392	338,102
Amortization of customer acquisition costs	201,758	119,109
Depreciation expense	187,895	43,000
Loss (gain) on change in value of warrant liability	4,256,600	(1,316,729)
Noncash debt issuance costs	1,096,000	-
Debt conversion costs	-	961,843
PIK Interest	467,892	539,994
<b>Change in assets and liabilities</b>		
Increase in accounts receivable	(3,077,407)	(252,942)
Decrease (increase) in inventory	1,838,146	(597,173)
(Increase) decrease in prepaid expenses and other assets	(1,977)	11,645
Increase (decrease) in accounts payable and accrued liabilities	3,292,440	(226,830)
(Decrease) increase in deferred revenue	(2,241,928)	227,549
<b>Net cash provided by (used in) operating activities</b>	<b>456,547</b>	<b>(2,593,727)</b>
<b>Cash flows used in investing activities</b>		
Purchase of property and equipment	(907,898)	(660,324)
<b>Net cash used in investing activities</b>	<b>(907,898)</b>	<b>(660,324)</b>

<b>Cash flows from financing activities</b>			
Payment of convertible promissory notes		-	(3,000,000)
Payment of equipment notes payable		(12,865)	-
<b>Net cash used in financing activities</b>		(12,865)	(3,000,000)
<b>Net decrease in cash and cash equivalents</b>			
		(464,216)	(6,254,051)
<b>Cash and cash equivalents - beginning of period</b>			
		1,083,280	7,212,114
<b>Cash and cash equivalents - end of period</b>			
	\$	619,064	\$ 958,063
<b>SUPPLEMENTAL CASH FLOW INFORMATION:</b>			
Cash paid during the period for:			
Interest	\$	98,007	\$ 256
<b>SUPPLEMENTAL DISCLOSURE OF NON-CASH TRANSACTIONS</b>			
Equipment purchases included in accounts payable	\$	-	\$ 57,030
Issuance of common stock as payment of interest on convertible notes payable	\$	103,635	\$ 104,005
Conversion of debt and accrued interest to equity	\$	-	\$ 3,574,552
Conversion of accounts receivable to customer acquisition costs	\$	188,225	\$ -
Equipment purchases included in notes payable	\$	103,428	\$ -

*The accompanying notes are an integral part of these condensed consolidated financial statements.*

Table of Contents

**Midwest Energy Emissions Corp. and Subsidiaries**

**Notes to Condensed Consolidated Financial Statements**

***Note 1 - Organization***

*Midwest Energy Emissions Corp.*

Midwest Energy Emissions Corp. (the "Company") is organized under the laws of the State of Delaware with 150,000,000 authorized shares of common stock, par value \$.001 per share and 2,000,000 authorized shares of preferred stock, par value \$0.001 per share.

*MES, Inc.*

MES, Inc. is incorporated in the State of North Dakota. MES, Inc. is a wholly owned subsidiary of Midwest Energy Emissions Corp. and is engaged in the business of developing and commercializing state of the art control technologies relating to the capture and control of mercury emissions from coal fired boilers in the United States and Canada.

***Note 2 - Summary of Significant Accounting Policies***

*Basis of Presentation*

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") and pursuant to the rules and regulations of the United States Securities and Exchange Commission ("SEC") for interim financial information. Accordingly, these financial statements do not include all of the information and footnotes required for complete financial statements and should be read in conjunction with the audited consolidated financial statements and accompanying notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2015.

In management's opinion, the unaudited condensed consolidated financial statements reflect all adjustments necessary to present fairly the financial position as of June 30, 2016, and results of operations, changes in stockholders' deficit and cash flows for all periods presented. The interim results presented are not necessarily indicative of results that can be expected for a full year.

*Use of Estimates*

The preparation of 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 and disclosures of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Table of Contents

*Cash and Cash Equivalents*

The Company considers all highly liquid debt instruments and other short-term investments with maturity of three months or less, when purchased, to be cash equivalents. The Company maintains its cash in three accounts with one financial institution, which at times may exceed federally insured limits.

In addition, per the financing agreement entered into with AC Midwest LLC (the "Lender") (see Note 7), the Company is not permitted to use cash to pay interest accruing on unsecured convertible promissory notes. Also, should the Company be unable to raise sufficient capital to pay off such notes or otherwise induce the holders thereof to convert their notes to common stock, it will not be permitted to pay them off under the terms of the Financing Agreement without the prior consent of the Lender.

*Accounts Receivable*

Trade accounts receivable are stated at the amount the Company expects to collect. The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. Management considers the following factors when determining the collectability of specific customer accounts: customer credit-worthiness, past transaction history with the customer, current economic industry trends, and changes in customer payment terms. Past due balances over 90 days and other higher risk amounts are reviewed individually for collectability. If the financial condition of the Company's customers were to deteriorate, adversely affecting their ability to make payments, additional allowances would be required. Based on management's assessment, the Company provides for estimated uncollectible amounts through a charge to earnings and a credit to a valuation allowance. Balances that remain outstanding after the Company has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to accounts receivable. At June 30, 2016 and December 31, 2015, the allowance for doubtful accounts was zero.

*Inventory*

Inventories are stated at the lower of cost (first-in, first-out basis) or market (net realizable value).

*Property and Equipment*

Property and equipment are stated at cost. When retired or otherwise disposed, the related carrying value and accumulated depreciation are removed from the respective accounts and the net difference less any amount realized from disposition, is reflected in earnings. For consolidated financial statement purposes, property and equipment are recorded at cost and depreciated using the straight-line method over their estimated useful lives of 3 to 5 years.

Expenditures for repairs and maintenance which do not materially extend the useful lives of property and equipment are charged to operations. Management periodically reviews the carrying value of its property and equipment for impairment.

*Recoverability of Long-Lived and Intangible Assets*

The Company has adopted ASC 360-10, *Property, Plant and Equipment* ("ASC 360-10"). ASC 360-10 requires that long-lived assets and certain identifiable intangibles held and used by the Company be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable.



Table of Contents

Events relating to recoverability may include significant unfavorable changes in business conditions, recurring losses or a forecasted inability to achieve break-even operating results over an extended period. The Company evaluates the recoverability of long-lived assets based upon forecasted undiscounted cash flows. Should impairment in value be indicated, the carrying value of the long-lived and or intangible assets would be adjusted, based on estimates of future discounted cash flows. During the quarter ended June 30, 2016, as a result of recurring losses and an accumulated deficit, the Company identified a triggering event requiring a test for the recoverability of long-lived assets and intangible assets. Assessing the recoverability of long-lived assets and intangible assets requires significant judgments and estimates by management. Management concluded that the fair value of long-lived assets and intangible assets exceeded their carrying value and as such, no impairment charges were recognized for the quarters ended June 30, 2016 and 2015, respectively.

A significant decrease in the market price of a long-lived asset, adverse change in the use or condition of a long-lived asset, adverse change in the business climate or legal or regulatory factors impacting a long-lived asset and intangible assets and continued operating losses, accumulated deficit and cash flow deficiencies among other indicators, could cause a future assessment to be performed which may result in an impairment of long-lived assets and intangible assets resulting in a material adverse effect on the financial position and results of operations of the Company.

*Stock-Based Compensation*

The Company accounts for stock-based compensation awards in accordance with the provisions of ASC 718, *Compensation—Stock Compensation* ("ASC 718"), which requires equity-based compensation, be reflected in the consolidated financial statements over the period of service which is typically the vesting period based on the estimated fair value of the awards.

*Derivative Liabilities*

The Company does not use derivative instruments to hedge exposures to cash flow, market or foreign currency risks; however, the Company has certain financial instruments that are embedded derivatives associated with capital raises and common stock purchase warrants. The Company evaluates all its financial instruments to determine if those contracts or any potential embedded components of those contracts qualify as derivatives to be separately accounted for in accordance with FASB ASC 815-10. This accounting treatment requires that the carrying amount of any embedded derivatives be recorded at fair value at issuance and marked-to-market at each balance sheet date. In the event that the fair value is recorded as a liability, as is the case with the Company, the change in the fair value during the period is recorded as either income or expense. Upon conversion or exercise, the derivative liability is marked to fair value at the conversion date and then the related fair value is reclassified to equity.

*Fair Value of Financial Instruments*

The fair value hierarchy has three levels based on the inputs used to determine fair value, which are as follows:

- *Level 1* — Unadjusted quoted prices available in active markets for the identical assets or liabilities at the measurement date.

Table of Contents

The fair value hierarchy requires the use of observable market data when available. In instances where the inputs used to measure fair value fall into different levels of the fair value hierarchy, the fair value measurement has been determined based on the lowest level input significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular item to the fair value measurement in its entirety requires judgment, including the consideration of inputs specific to the asset or liability.

Cash and cash equivalents were the only asset measured at fair value on a recurring basis by the Company at June 30, 2016 and December 31, 2015 and is considered to be Level 1. Warrant liability is considered to be Level 3, and is the only liability measured at fair value on a recurring basis as of June 30, 2016 and December 31, 2015.

Financial instruments include cash and cash equivalents, accounts receivable, accounts payable, accrued expenses, deferred revenue, customer credits and short-term debt. The carrying amounts of these financial instruments approximated fair value at June 30, 2016 and December 31, 2015 due to their short-term maturities. The fair value of the convertible promissory notes payable at June 30, 2016 and December 31, 2015 approximated the carrying amount as the notes were issued during the three years ended December 31, 2015 at interest rates prevailing in the market and interest rates have not significantly changed as of June 30, 2016. The fair value of the convertible promissory notes payable was determined on a Level 2 measurement.

The Company has entered into certain financial instruments and contracts; such as, equity financing arrangements for the issuance of common stock, which include anti-dilution arrangements and detachable stock warrants that are i) not afforded equity classification, ii) embody risks not clearly and closely related to host contracts, or iii) may be net-cash settled by the counterparty. These instruments are recorded as derivative liabilities, at fair value at the issuance date. Subsequent changes in fair value are recorded through the consolidated statements of operations.

The Company's derivative liabilities are related to detachable common stock purchase warrants ("warrants") issued in conjunction with debt and warrants issued to the placement agents for financial instrument issuances. We estimate fair values of the warrants that do contain "Down Round Protections" utilizing valuation models and techniques that have been developed and are widely accepted that take into account the additional value inherent in "Down Round Protection." These widely accepted techniques include "Modified Binomial", "Monte Carlo Simulation" and the "Lattice Model." The "core" assumptions and inputs to the "Modified Binomial" model are the same as for "Black-Scholes", such as trading volatility, remaining term to maturity, market price, strike price, and risk free rates; all Level 2 inputs. Fair value measurements are classified according to the lowest level input or value-driver that is significant to the valuation. A measurement may therefore be classified within Level 3 even though there may be significant inputs that are readily observable. However, a key input to a "Modified Binomial" model (in our case, the "Monte Carlo Simulation", for which we engaged an independent valuation firm to perform) is the probability of a future capital raise. By definition, this input assumption does not meet the requirements for Level 1 or Level 2 outlined above; therefore, the entire fair value calculation is deemed to be Level 3 under accounting requirements due to this single Level 3 assumption. This input to the Monte Carlo Simulation model was developed with significant input from management based on its knowledge of the business, current financial position and the strategic business

plan with its best efforts.

As discussed above, financial liabilities are considered Level 3 when their fair values are determined using pricing models or similar techniques and at least one significant model assumption or input is unobservable. For the Company, the Level 3 financial liability is the derivative liability related to the warrants that include "Down Round Protection" and they were valued using the "Monte Carlo Simulation" technique. This technique, while the majority of inputs are Level 2, necessarily incorporates various assumptions associated with a Capital Raise which are unobservable and, therefore, a Level 3 input.

12

Table of Contents

The table below provides a summary of the changes in fair value of the warrant liability measured at fair value on a recurring basis:

Balance at January 1, 2015	\$ 5,597,011
Issuance of warrants	1,008,000
Warrants to be issued	55,200
Change in value of warrant liability	3,194,189
Balance at December 31, 2015	\$ 9,854,400
Warrants issued	1,096,000
Change in value of warrant liability	4,256,600
Balance at June 30, 2016	\$ 15,207,000

*Revenue Recognition*

The Company records revenue from sales in accordance with ASC 605, *Revenue Recognition* ("ASC 605"). The criteria for recognition are as follows:

1. Persuasive evidence of an arrangement exists;

Determination of criteria (3) and (4) is based on management's judgments regarding the fixed nature of the selling prices of the products delivered and the collectability of those amounts. Provisions for discounts and rebates to customers, estimated returns and allowances, and other adjustments is provided for in the same period the related sales are recorded.

The Company recorded customer acquisition costs totaling \$188,225 through June 30, 2016 and zero during the year ended December 31, 2015. The Company entered into agreements with three new customers during this period. The capitalized balance of customer acquisition costs was \$883,895 and \$897,428 on June 30, 2016 and December 31, 2015, respectively. Amortization expense for the quarters ended June 30, 2016 and 2015 was \$201,758 and \$119,109, respectively.

In accordance with the terms of its customer agreements, the Company made progress billings to four customers which relate to the fabrication, delivery and installation of new equipment, which is included as deferred revenue at June 30, 2016 and December 31, 2015 and is expected to be recognized as revenue during the year ended 2016 when

the equipment is commissioned for use by the customers.

The Company generated revenues of \$12,765,520 and \$2,940,029 for the six months ended June 30, 2016 and 2015, respectively. The Company generated revenue for the quarters ended June 30, 2016 and 2015 by delivering product and equipment to its commercial customers and completing demonstrations of its technologies at potential customer sites.

Table of Contents

*Income Taxes*

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the consolidated financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets, including tax loss and credit carryforwards, and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Deferred income tax expense represents the change during the period in the deferred tax assets and deferred tax liabilities. The components of the deferred tax assets and liabilities are individually classified as current and non-current based on their characteristics. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

The recognition, measurement and disclosure of uncertain tax positions recognized in an enterprise's consolidated financial statements are based on a more-likely-than-not recognition threshold. The Company did not have any unrecognized tax benefits at June 30, 2016 and December 31, 2015. When necessary, the Company would accrue penalties and interest related to unrecognized tax benefits as a component of income tax expense.

The Company and its subsidiaries file a consolidated income tax return in the U.S. federal jurisdiction and three state jurisdictions. The Company is no longer subject to U.S. federal examinations for years prior to 2012 or state tax examinations for years prior to 2011.

*Basic and Diluted Income (Loss) per Common Share*

Basic net income (loss) per common share is computed using the weighted average number of common shares outstanding. Diluted income (loss) per share reflects the potential dilution from common stock equivalents, such as stock issuable pursuant to the exercise of stock options and warrants. There were no dilutive potential common shares as of June 30, 2016 and 2015, because the Company incurred net losses and basic and diluted losses per common share are the same. For the three months ended June 30, 2015, basic and diluted earnings per share approximated each other. Dilutive potential common shares as of June 30, 2016 and 2015 were approximately 57.6 million shares and 23.7 million shares, respectively. Anti-dilutive potential common shares as of June 30, 2016 and 2015 were approximately 3.5 million shares and 26.7 million shares, respectively.

*Concentration of Credit Risk*

Financial instruments that subject the Company to credit risk consist of cash and equivalents on deposit with financial institutions and accounts receivable. The Company's cash as of June 30, 2016 and December 31, 2015 is on deposit in a non-interest-bearing transaction account that is subject to FDIC deposit insurance limits. For the quarters ended June 30, 2016 and 2015, 100% of the Company's revenue related to seven and five customers, respectively. For the six months ended June 30, 2016 and 2015, 100% of the Company's revenue related to eight and five customers, respectively. At June 30, 2016 and December 31, 2015, 100% of the Company's accounts receivable related to six and five customers, respectively.

### *Contingencies*

Certain conditions may exist which may result in a loss to the Company, but which will only be resolved when one or more future events occur or fail to occur. The Company's management and its legal counsel assess such contingent liabilities, and such assessment inherently involves an exercise of judgment. In assessing loss contingencies related to legal proceedings that are pending against the Company, or unasserted claims that may result in such proceedings, the Company's legal counsel evaluates the perceived merits of any legal proceedings or unasserted claims as well as the perceived merits of the amount of relief sought or expected to be sought therein.



Table of Contents

If the assessment of a contingency indicates that it is probable that a material loss has been incurred and the amount of the liability can be estimated, the estimated liability would be accrued in the Company's consolidated financial statements. If the assessment indicates that a potentially material loss contingency is not probable but is reasonably possible, or is probable but cannot be estimated, the nature of the contingent liability, together with an estimate of the range of possible loss if determinable and material, would be disclosed.

Loss contingencies considered remote are generally not disclosed unless they arise from guarantees, in which case the guarantees would be disclosed.

*Reclassification*

Certain amounts in the prior year have been reclassified to conform to the current presentation. Certain costs reported as operating expenses in 2015 were reclassified into cost of sales and selling, general and administrative expenses. There was no change to operating loss or net income (loss) due to these reclassifications for the periods presented herein.

*Recently Issued Accounting Standards*

In May, 2014, the FASB issued Accounting Standards Update 2014-09, Revenue from Contracts with Customers (Topic 606) Summary - The FASB has made available Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers: Topic 606. ASU 2014-09 affects any entity using U.S. GAAP that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards (e.g., insurance contracts or lease contracts). This ASU will supersede the revenue recognition requirements in Topic 605, Revenue Recognition, and most industry-specific guidance. This ASU also supersedes some cost guidance included in Subtopic 605-35, Revenue Recognition-Construction-Type and Production-Type Contracts. In addition, the existing requirements for the recognition of a gain or loss on the transfer of nonfinancial assets that are not in a contract with a customer (e.g., assets within the scope of Topic 360, Property, Plant, and Equipment, and intangible assets within the scope of Topic 350, Intangibles-Goodwill and Other) are amended to be consistent with the guidance on recognition and measurement (including the constraint on revenue) in this ASU. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve that core principle, an entity should apply the following steps: .

Step Identify the contract(s) with a customer.

1:

For a public entity, the amendments in this ASU are effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early application is not permitted. We are currently assessing the impact this standard will have on the Company's consolidated financial statements and required disclosures.

Table of Contents

In August, 2014, the FASB issued Accounting Standards Update (ASU) No. 2014-15, *Presentation of Financial Statements—Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to continue as a Going Concern*. ASU 2014-15 is intended to define management's responsibility to evaluate whether there is substantial doubt about an organization's ability to continue as a going concern and to provide related footnote disclosures. Under GAAP, financial statements are prepared under the presumption that the reporting organization will continue to operate as a going concern, except in limited circumstances. Financial reporting under this presumption is commonly referred to as the going concern basis of accounting. The going concern basis of accounting is critical to financial reporting because it establishes the fundamental basis for measuring and classifying assets and liabilities. Currently, GAAP lacks guidance about management's responsibility to evaluate whether there is substantial doubt about the organization's ability to continue as a going concern or to provide related footnote disclosures. This ASU provides guidance to an organization's management, with principles and definitions that are intended to reduce diversity in the timing and content of disclosures that are commonly provided by organizations today in the financial statement footnotes. The amendments are effective for annual periods ending after December 15, 2016, and interim periods within annual periods beginning after December 15, 2016. Early application is permitted for annual or interim reporting periods for which the financial statements have not previously been issued. We are currently assessing the impact this standard will have on the Company's consolidated financial statements and required disclosures.

In April, 2015, the FASB issued Accounting Standards Update (ASU) No. 2015-03, *Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs*. The amendments in this ASU require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in this ASU. For public business entities, the amendments are effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. The amendments should be applied on a retrospective basis, wherein the balance sheet of each individual period presented should be adjusted to reflect the period-specific effects of applying the new guidance. Upon transition, an entity is required to comply with the applicable disclosures for a change in an accounting principle. These disclosures include the nature of and reason for the change in accounting principle, the transition method, a description of the prior-period information that has been retrospectively adjusted, and the effect of the change on the financial statement line items (i.e., debt issuance cost asset and the debt liability). We have adopted this standard in the current presentation of the Company's consolidated financial statements and required disclosures. By adopting this standard, the Company's balance sheet presentation has changed as certain assets have been reclassified to a liability. The adoption does not alter the accounting for the amortization of debt issuance costs

In June, 2015, the FASB issued Accounting Standards Update (ASU) No. 2015-11, *Inventory (Subtopic 330): Simplifying the measurement of Inventory*. The amendments in this ASU require inventory be measured at the lower of cost and net realizable value. For public business entities, the amendments are effective for financial statements issued for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years. The amendments should be applied prospectively with earlier application permitted as of the beginning of an interim or annual reporting period. We are currently assessing the impact this standard will have on the Company's consolidated financial statements and required disclosures.

In February, 2016, the FASB issued Accounting Standards Update (ASU) No. 2016-11, *Leases (Topic 842)*. Under the new guidance, lessees will be required to recognize a lease liability and right-of-use asset at the commencement date for all leases, with the exception of short term leases. For public business entities, the amendments are effective for financial statements issued for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. We are currently assessing the impact this standard will have on the Company's consolidated financial statements and required disclosures.

In March, 2016, the FASB issued Accounting Standards Update (ASU) No. 2016-09, *Stock Compensation (Topic 718)*. This amendment is intended to improve and simplify the accounting for employee share-based payments including areas such as (a) income tax consequences; (b) classification of awards as either equity or liabilities; and (c) classification on the statement of cash flows.. For public business entities, the amendments are effective for financial statements issued for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years. We are currently assessing the impact this standard will have on the Company's consolidated financial statements and required disclosures.

Table of Contents

***Note 3 - Going Concern***

The accompanying consolidated financial statements as of June 30, 2016 have been prepared assuming the Company will continue as a going concern. Since its inception, the Company has experienced recurring losses and has an accumulated deficit of \$45,335,000. The Company has current convertible notes payments due of \$4,042,000. These principal payments raise doubt about the Company's ability to continue as a going concern. Although we anticipate significant revenues and cash generation from sales of products to be used in MATS compliance activities, no assurances can be given that the Company can obtain sufficient working capital through these activities to meet its debt obligations. Due to certain covenants with our senior lender, we are not able to use current cash on hand to pay current convertible note holders as these notes mature. Success in our ongoing operations and continued negotiations with our note holders is critical. We will actively seek sources of additional financing in order to fund our debt repayment obligations if extensions cannot be negotiated with our early investors who purchased convertible debt from the Company. No assurances can be given that the Company can maintain sufficient working capital through these efforts or that the continued implementation of its business plan will generate sufficient revenues in the future to sustain ongoing operations.

The accompanying consolidated financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classifications of liabilities that may result from the possible inability of the Company to continue as a going concern.

***Note 4 - Inventory***

During the year ended December 31, 2015, the Company began the production of equipment to be sold to its customers. As of June 30, 2016 and December 31, 2015, costs totaling \$316,300 and \$2,430,846, respectively, were incurred for component purchases and progress billings from subcontractors on these projects. These costs will be recorded as cost of sales as the systems are commissioned for use by the Company's customers. The Company also held product supply inventory valued at \$561,467 and \$285,067 as of June 30, 2016 and December 31, 2015, respectively.

***Note 5 - Property and Equipment, Net***

Property and equipment at June 30, 2016 and December 31, 2015 are as follows:

Edgar Filing: Midwest Energy Emissions Corp. - Form 10-Q

	<b>June 30</b>		<b>December 31</b>
	<b>2016</b>		<b>2015</b>
Equipment & Installation	\$ 1,517,514	\$	1,113,310
Trucking Equipment	814,655		648,328
Office Equipment	28,361		27,155
Computer Equipment and Software	106,632		97,530
<b>Total Equipment</b>	<b>2,467,162</b>		<b>1,886,323</b>
Less: Accumulated Depreciation	(1,144,782)		(956,887)
Construction in Process	744,501		314,014
	<b>\$ 2,066,881</b>	\$	<b>1,243,450</b>

The Company uses the straight-line method of depreciation over 3 to 5 years. During the quarters ended June 30, 2016 and 2015 depreciation expense charged to operations was \$188,000 and \$43,000, respectively.

Table of Contents**Note 6 - License Agreement**

On January 15, 2009, the Company entered into an "Exclusive Patent and Know-How License Agreement Including Transfer of Ownership" with the Energy and Environmental Research Center Foundation, a non-profit entity ("EERCF"). Under the terms of the Agreement, the Company has been granted an exclusive license by EERCF for the technology to develop, make, have made, use, sell, offer to sell, lease, and import the technology in any coal-fired combustion systems (power plant) worldwide and to develop and perform the technology in any coal-fired power plant in the world. Amendments No. 4 and No. 5 to this agreement were made effective as of December 16, 2013 and August 14, 2014, respectively, expanding the number of patents covered, eliminated certain contract provisions and compliance issues and restructured the fee payments and buyout provisions while granting EERCF equity in the Company. This agreement now applies to 29 domestic and foreign patents and patent applications.

The Company paid EERCF \$100,000 in 2009 for the license to use the patents and at the option of the Company can pay \$2,500,000 and issue 875,000 shares of common stock for the assignment of the patents or pay the greater of the license maintenance fees or royalties on product sales for continued use of the patents. The license maintenance fees are \$25,000 due monthly beginning in January 1, 2014 and continuing each month thereafter. The running royalties are \$100 per one megawatt of electronic nameplate capacity and \$100 per three megawatt per hour for the application to thermal systems to which licensed products or licensed processes are sold by the Company, associate and sublicensees. Running royalties are payable by the Company within 30 days after the end of each calendar year to the licensor and may be credited against license maintenance fees paid. There were no royalties due for 2015. For 2016, the Company will owe approximately \$961,000 based on the current EGU's in operation, with approximately \$661,000 due in January 2017 if the Company has not received the assignment of the patents from the EERCF. As of June 30, 2016, the Company has recorded \$370,293 of royalty expense and \$220,293 is included in accrued expenses.

The Company is required to pay EERCF 35% of all sublicense income received by the Company, excluding royalties on sales by sublicensees. Sublicense income is payable by the Company within 30 day after the end of each calendar year to the licensor. This requirement ends at the time the Company pays for the assignment of the patents. There was no sublicense income in 2016 or 2015.

License costs capitalized as of June 30, 2016 and December 31, 2015 are as follows:

	<b>June 30</b>	<b>December</b>
	<b>2016</b>	<b>31</b>
		<b>2015</b>
License	\$ 100,000	\$ 100,000
Less: Accumulated Amortization	44,117	41,175

License, Net	\$	55,883	\$	58,825
--------------	----	--------	----	--------

The Company is currently amortizing its license to use EERCF's patents over their estimated useful life of 17 years when acquired. During the quarters ended June 30, 2016 and 2015, amortization expense charged to operations was \$2,942 and \$2,942, respectively. Estimated annual amortization for each of the next five years is approximately \$5,900.



Table of Contents*Note 7 – Convertible Notes Payable*

The Company has the following convertible notes payable outstanding as of June 30, 2016 and December 31, 2015:

	<b>2016</b>	<b>2015</b>
Unsecured convertible promissory notes which have a term of three years, bear interest at 12% per annum, and are convertible into units, where each unit consists of: (i) one share of common stock of the Company, par value \$0.001 per share, and (ii) a warrant to purchase 0.25 shares of common stock of the Company at an exercise price of \$1.00 per share. The conversion ratio shall be equal to \$0.75 per unit.	\$ 378,932	\$ 357,483
Unsecured convertible promissory notes which have a term of three years, bear interest at 12% per annum, and are convertible into units, where each unit consists of: (i) 1 share of common stock of the Company, par value \$0.001 per share, and (ii) a warrant to purchase 0.25 shares of common stock of the Company at an exercise price of \$0.75 per share. The initial conversion ratio shall be equal to \$0.50 per unit.	779,411	735,293
Secured convertible promissory notes which mature on July 31, 2018, bear interest at 10% per annum, and are convertible into one share of common stock, par value \$0.001 per share, with the initial conversion ratio equal to \$0.50 per share.	1,645,000	1,645,000
Secured convertible note which matures on July 31, 2018, bear interest at 12% per annum, an is convertible into one share of common stock, par value \$0.001 per share, with the initial conversion ratio equal to \$0.50 per share.	9,529,912	9,062,019
Total convertible notes payable before discount and debt issuance costs	12,333,255	11,799,795
Less discounts	(3,561,385)	(4,413,119)
Less debt issuance costs	(1,380,085)	(1,714,477)
Total convertible notes payable	7,391,785	5,672,199
Less Current Portion	4,041,935	2,497,114
Convertible notes payable, net of current portion	\$ 3,349,850	\$ 3,175,085

Edgar Filing: Midwest Energy Emissions Corp. - Form 10-Q

As of June 30, 2016, scheduled principal payments due on convertible notes payable are as follows:

<b>Twelve months ended June 30,</b>	
2017	\$ 4,041,935
2018	2,883,593
2019	5,407,727
	\$ 12,333,255

Table of Contents

From April 26, 2012 to January 24, 2013, the Company sold convertible notes to unaffiliated accredited investors totaling \$2,675,244. The notes have a term of three years, bear interest at 12% per annum, and are convertible into units, where each unit consists of: (i) one share of common stock of the Issuer, par value \$0.001 per share, and (ii) a warrant to purchase 0.25 shares of common stock of the Issuer at an exercise price of \$1.25 per share. The initial conversion ratio shall be equal to \$1.00 per unit. The notes may be converted at the option of the holder at any time and from time to time in whole or in part prior to the maturity date thereof. These securities were sold in reliance upon the exemption provided by Section 4(2) of the Securities Act and the safe harbor of Rule 506 under Regulation D promulgated under the Securities Act. Interest expense for the six months ended June 30, 2016 and 2015, was \$22,736 and \$186,339, respectively.

During the year ended December 31, 2015, the Company and certain holders of these notes entered into amendments which (i) extend the maturity dates by 12 months from their original maturity dates; (ii) reduce the conversion price from \$1.00 to \$0.50 per unit for a period of 45 days and \$0.75 thereafter; and (iii) reduce the exercise of the warrant included in the unit from \$1.25 to \$1.00 per share. During the year ended December 31, 2015, the holders of these notes totaling \$3,112,883 converted their notes into equity of the Company. The Company has converted this balance and along with accrued interest of \$124,352 into 6,474,717 shares of common stock and 1,618,680 warrants to purchase common stock. The Company recognized a non-cash inducement expense of \$1,123,380 associated with these conversions as they took place during the initial 45 day period after the amendment, prior to the conversion rate resetting to \$0.75. As of June 30, 2016 and December 31, 2015, total principal of \$378,932 and \$357,483, respectively, was outstanding on these notes to the remaining note holders that did not convert. During the three months ended June 30, 2016, the Company and the holders of the outstanding notes have entered into amendments which (i) extend the maturity dates by 12 months from their original maturity dates; (ii) reduce the conversion price from \$0.75 to \$0.50 per unit; and (iii) reduce the exercise of the warrant included in the unit from \$1.00 to \$0.75 per share.

From April 5 through May 10, 2013, the Company sold convertible notes to unaffiliated accredited investors totaling \$405,000. The notes have a term of three years, bear interest at 12% per annum, and are convertible into units, where each unit consists of: (i) 1 share of common stock of the Issuer, par value \$0.001 per share, and (ii) a warrant to purchase 0.25 shares of common stock of the Issuer at an exercise price of \$0.75 per share. The initial conversion ratio shall be equal to \$0.50 per unit. The notes may be converted at any time and from time to time in whole or in part prior to the maturity date thereof. These securities were sold in reliance upon the exemption provided by Section 4(2) of the Securities Act and the safe harbor of Rule 506 under Regulation D promulgated under the Securities Act. Interest expense for the six months ended June 30, 2016 and 2015, was \$33,112 and \$29,469, respectively. As of June 30, 2016 and December 31, 2015, total principal of \$551,862 and \$520,625, respectively, was outstanding on these notes. During the three months ended June 30, 2016, the Company and the holders of these notes have entered into amendments which (i) extend the maturity dates by six months from their original maturity dates and (ii) leave all other terms unchanged during this extension period.

On June 27 and June 30, 2013, the Company converted advances payable from then related parties into convertible notes totaling \$1,036,195. The notes have a term of three years, bear interest at 12% per annum, and are convertible into units, where each unit consists of: (i) 1 share of common stock of the Issuer, par value \$0.001 per share, and (ii) a

warrant to purchase 0.25 shares of common stock of the Issuer at an exercise price of \$0.75 per share. The initial conversion ratio shall be equal to \$0.50 per unit. The notes may be converted at any time and from time to time in whole or in part prior to the maturity date thereof. These securities were issued in reliance upon the exemption provided by Section 4(2) of the Securities Act and the safe harbor of Rule 506 under Regulation D promulgated under the Securities Act. During the year ended December 31, 2014, a total of \$866,211 of these notes together with the accrued interest thereon were converted into equity of the Company, leaving one note with such then related parties outstanding. Interest expense for the six months ended June 30, 2016 and 2015, was \$13,653 and \$12,151, respectively. As of June 30, 2016 and December 31, 2015, total principal of \$227,549 and \$214,668, respectively, was outstanding on this remaining note. As of June 30, 2016, the outstanding note reached its maturity date and has not been extended by the note holder. Such note will continue to accrue interest until converted or repaid.

Table of Contents

From July 30, 2013 through December 24, 2013, the Company sold convertible notes and warrants to unaffiliated accredited investors totaling \$1,902,500. The notes have a term of three years, bear interest at 10% per annum, and are convertible into one share of common stock, par value \$0.001 per share, with the initial conversion ratio equal to \$0.50 per share. For each dollar invested, the investor received two warrants to purchase one shares of common stock of the Issuer at an exercise price of \$0.75 per share. The notes may be converted at any time and from time to time in whole or in part prior to the maturity date thereof. These securities were sold in reliance upon the exemption provided by Section 4(2) of the Securities Act and the safe harbor of Rule 506 under Regulation D promulgated under the Securities Act. Subject to an allonge entered into by the noteholder agent representing this class of noteholders and the Company, the maturity date on all of these convertible notes was extended to July 31, 2018. Interest expense for the quarters ended June 30, 2016 and 2015, was \$159,565 and \$57,575, respectively. A discount on the notes payable of \$841,342 was recorded based on the value of the warrants issued using a Black-Scholes options pricing model. Amortized interest expense for the quarters ended June 30, 2016 and 2015 on this discount was \$76,061 and \$75,644, respectively. As of June 30, 2016 and December 31, 2015, total principal of \$1,645,000 was outstanding on these notes.

On August 14, 2014, the Company and its wholly-owned subsidiary MES, Inc. ("MES, and together with the Company, collectively the "Companies") entered into a financing agreement (the "Financing Agreement") with a newly created independent entity, AC Midwest Energy LLC (the "Lender"). Pursuant to the Financing Agreement, the Company borrowed \$10,000,000 from the Lender, evidenced by a convertible note (the "Note") maturing July 31, 2018, secured by all the assets of the Companies. All the indebtedness under the Note was convertible into common stock of the Company at \$1.00 per share, subject to the following adjustments: (i) an adjustment of the price per share down to \$0.75 per share if the Company fails to generate EBITDA (earnings before taxes, interest, depreciation and amortization ) of at least \$2,500,000 for calendar year 2015; and (ii) weighted average anti-dilution adjustments to the extent that following the issuance of the Note, the Company issues securities or rights to acquire securities at an effective purchase price below the conversion price for the Note, subject to carveouts for certain exempt issuances by the Company. Per an amendment to the Financing Agreement discussed below, the conversion price was adjusted to \$0.50 per share and the adjustment to the price per share for failing to generate a certain level of EBITDA was eliminated.

The Note bears interest at 12% per annum, to be paid at the rate of: (i) 12% payment in kind or "PIK" for year one; (ii) 2% cash and 10% PIK for year two; and (iii) 12% all cash for years three and four. The PIK interest is paid by increasing the principal balance of the Note by the PIK amount. The Note cannot be prepaid without the Lender's consent before its second anniversary, and thereafter at 105% of the outstanding indebtedness evidenced by the Note, subject to the right of the Lender to convert the outstanding indebtedness to the Company's common stock prior to prepayment. Principal amortization of the Note is to begin with the first quarter following the second year of the Note at the rate of 7.5% of the original principal amount per quarter and to continue each quarter thereafter, with all unpaid interest to be due at maturity. In the event of default, the interest rate on the Note will be increased by an additional 3% per annum. The Financing Agreement contains numerous affirmative obligations and negative covenants. Interest expense for the six months ended June 30, 2016 and 2015 was \$664,806 and \$539,994, respectively. As of June 30, 2016 and December 31, 2015, total principal of \$9,529,912 and \$9,062,019, respectively, was outstanding on this note.

On March 16, 2015, the Company entered into a Waiver and Amendment to Financing Agreement, and Reaffirmation of Guaranty with AC Midwest Energy, LLC ("Amendment"). This Amendment decreased the conversion price of the convertible note and exercise price of the outstanding warrants to \$0.50, respectively. The Company repaid \$3,000,000 of outstanding principal on the convertible note as of the close of the Amendment. The Company agreed to new financial covenants as part of the Amendment, which included a waiver for the compliance of certain covenants in the periods prior to the date of the Amendment. In connection with the change in the conversion terms and repayment of principal, the Company incurred a loss of \$2,246,105 on this date which was primarily related to accelerated amortization of the discount on convertible notes payable and is included in interest expense.

On November 16, 2015, the Companies entered into Waiver and Amendment No. 2 to Financing Agreement, and Reaffirmation of Guaranty (the "Amendment No. 2") with the Lender. Pursuant to Amendment No. 2, the Company issued a new Senior Secured Convertible Note of \$600,000 ("First New Note") purchased by the Lender. In addition, Amendment No. 2 allows for two additional Senior Secured Convertible Notes totaling up to \$1,400,000 (which together with the First New Note are referred to herein as the "New Notes") to be purchased by Lender during 2016 subject to certain conditions being met by both parties. All the indebtedness under the New Notes shall be convertible into common stock of the Company at \$0.50 per share, subject to weighted average anti-dilution adjustments to the extent that following the issuance of the New Notes, the Company issues securities or rights to acquire securities at an effective purchase price below the conversion price for the New Notes. As of January 31, 2016, the Company's right to sell one additional New Note for \$400,000 expired. The remaining \$1,000,000 available with this amendment must be sold to Lender by June 30, 2016. In connection with Amendment No. 2, the Company was required to issue Drexel approximately 200,000 warrants and pay \$21,000 as compensation for services rendered. This liability was settled with an amendment to the engagement letter with Drexel on February 19, 2016. These warrants were valued in accordance with FASB ASC 815-10 as liabilities using a Monte Carlo Simulation Model. The fair value of the warrant liability on the issuance date for the warrants to be issued was \$55,200. These costs were recorded as debt issuance costs.

Table of Contents

On January 28, 2016, the Company entered into Amendment No. 3 to Financing Agreement and Reaffirmation of Guaranty (the "Third Amended Financing Agreement") with Lender, pursuant to which Lender agreed to cause its bank to arrange for the issuance to a certain customer of the Company a standby letter of credit in the amount of \$2,000,000 (the "Letter of Credit") to permit the Company to enter into a contract for mercury capture program with such customer. The Letter of Credit is to guarantee the Company's performance under its contract with such customer. Under the Third Amended Financing Agreement, and in consideration for the issuance of the Letter of Credit for the benefit of the Company, the Company shall pay AC Midwest a fee equal to 12.0% per annum of the amount available to be drawn under the Letter of Credit (the "Letter of Credit Fee") payable on the last day of each calendar month. No amounts were received on this letter of credit as of June 30, 2016.

**Note 8 – Equipment Notes Payable**

The Company has the following equipment notes payable outstanding as of June 30, 2016 and December 31, 2015:

	<b>2016</b>	<b>2015</b>
On September 30, 2015, the Company entered into a retail installment purchase contract in the amount of \$57,007, secured by a 2016 Dodge Ram 5500 purchased on that date. This installment loan bears interest at a fixed rate of 4.22% and the Company shall make 60 monthly payments of \$1,056 beginning October 30, 2015.	\$ 49,202	\$ 54,433
On December 15, 2015, the Company entered into a retail installment purchase contract in the amount of \$56,711, secured by a 2016 Dodge Ram 5500 purchased on that date. This installment loan bears interest at a fixed rate of 4.22% and the Company shall make 60 monthly payments of \$1,050 beginning January 15, 2016.	51,562	56,711
On March 8, 2016, the Company entered into a retail installment purchase contract in the amount of \$46,492, secured by a 2016 Dodge Ram 2500 purchased on that date. This installment loan bears interest at a fixed rate of 5.62% and the Company shall make 72 monthly payments of \$764 beginning April 8, 2016.	44,846	-
On May 26, 2016, the Company entered into a retail installment purchase contract in the amount of \$56,936, secured by a 2016 Dodge Ram 5500 purchased on that date. This installment loan bears interest at a fixed rate of 4.89% and the Company shall make 60 monthly payments of \$1,072 beginning June 26, 2016.	56,097	-
<b>Total equipment notes payable</b>	<b>201,707</b>	<b>111,144</b>

Edgar Filing: Midwest Energy Emissions Corp. - Form 10-Q

Less Current Portion	38,593	20,979
Convertible notes payable, net of current portion	\$ 163,114	\$ 90,165

As of June 30, 2016, scheduled principal payments due on convertible notes payable are as follows:

<b>Twelve months ended June 30,</b>	
2017	\$ 38,593
2018	40,426
2019	42,347
2020	44,360
2021	29,408
2022	6,573
	\$ 201,707



Table of Contents*Note 9 – Warrant Liability*

On August 14, 2014, Company issued the Lender a warrant to purchase 12,500,000 shares of the Company's common stock at \$1.00 per share, subject to the adjustments (see Note 13 for changes to the terms of these warrants). The Company also issued to Drexel for the transaction: (i) a 5-year warrant to purchase up to 800,000 shares of common stock at \$1.00 per share; and (ii) a 5-year warrant to purchase up to 1,000,000 shares of common stock at \$0.50 per share, both subject to adjustments similar to the Warrant issued to the Lender (see Note 13 for changes to the terms of these warrants). These warrants were valued in accordance with FASB ASC 815-10 as liabilities using a Monte Carlo Simulation Model. The fair value of the warrant liability on the issuance date for all warrants issued was \$9,801,200. The warrants issued to Drexel were valued at \$1,251,200 and were recorded as transaction costs associated with Financing Agreement. As of December 31, 2015, per a new valuation performed in accordance with FASB ASC 815-10, the total value of these warrants was adjusted to \$7,872,000. As of March 31, 2016, pursuant to a new valuation performed in accordance with FASB ASC 815-10, the total value of these warrants was adjusted to \$5,199,000 and a gain for the change in value of the liability of \$2,673,000 was recognized. As of June 30, 2016, pursuant to a new valuation performed in accordance with FASB ASC 815-10, the total value of these warrants was adjusted to \$10,546,000 and a loss for the change in value of the liability of \$5,347,000 was recognized. The significant assumptions considered by the model were the remaining term of the warrants, operational forecasts provided by the Company, the fair value per share stock price of \$0.90 and \$0.33, a risk free treasury rate for 0.71% and 0.92% and an expected volatility rate of 90.4% and 85.8% at June 30, 2016 and December 31, 2015, respectively.

On November 16, 2015, Company issued the Lender a contingent warrant to purchase up to 5,000,000 shares of the Company's common stock at \$0.35 per share, subject to adjustments, which warrant shall be immediately exercisable for 3,600,000 shares with the balance of 1,400,000 shares exercisable proportionately to such additional Senior Convertible Notes up to \$1,400,000 purchased by the Lender (see Note 13 for the terms of these warrants). These warrants were valued in accordance with FASB ASC 815-10 as liabilities using a Monte Carlo Simulation Model. The fair value of the warrant liability on the issuance date for all warrants issued was \$1,008,000. \$840,000 of this amount was considered a waiver fee and was recorded as a settlement charge. \$168,000 was recorded as a discount on notes payable. As of December 31, 2015, per a new valuation performed in accordance with FASB ASC 815-10, the total value of these warrants was adjusted to \$1,872,000. As of March 31, 2016, pursuant to a new valuation performed in accordance with FASB ASC 815-10, the total value of these warrants was adjusted to \$1,476,000 and a gain for the change in value of the liability of \$396,000 was recognized. As of June 30, 2016, pursuant to a new valuation performed in accordance with FASB ASC 815-10, the total value of these warrants was adjusted to \$2,844,000 and a loss for the change in value of the liability of \$1,368,000 was recognized.

On January 28, 2016, in consideration for the issuance of the Letter of Credit, the Company has agreed to issue to Lender (i) a five year warrant to purchase 2,000,000 shares of common stock at an exercise price of \$0.35 per share of common stock (the "Third Warrant"), and (ii) a Senior Secured Letter of Credit Note (the "LC Note") to evidence any indebtedness owed by the Company arising from any draws made under the Letter of Credit. The Third Warrant shall be subject to certain anti-dilution adjustments including percentage based anti-dilution protection requiring that the aggregate number of shares of common stock purchasable upon its initial exercise not be less than an amount equal to 7.2% of the Company's then outstanding shares of capital stock on a fully diluted basis. These warrants were valued in

accordance with FASB ASC 815-10 as liabilities using a Monte Carlo Simulation Model. The fair value of the warrant liability on the issuance date for all warrants issued was \$1,040,000. As of March 31, 2016, pursuant to a new valuation performed in accordance with FASB ASC 815-10, the total value of these warrants was adjusted to \$840,000 and a gain for the change in value of the liability of \$200,000 was recognized. As of June 30, 2016, pursuant to a new valuation performed in accordance with FASB ASC 815-10, the total value of these warrants was adjusted to \$1,580,000 and a loss for the change in value of the liability of \$740,000 was recognized.

On February 19, 2016, in connection to Amendment No. 2 and Amendment No. 3, the Company issued Drexel: a 5-year warrant to purchase up to 300,000 shares of common stock at \$0.35 per share as compensation for services rendered. 200,000 of these warrants were valued in accordance with FASB ASC 815-10 as liabilities using a Monte Carlo Simulation Model as of November 16, 2015. The fair value of the warrant liability on the issuance date for the warrants to be issued was \$55,200 which was recorded as debt issuance costs. As of December 31, 2015, per a new valuation performed in accordance with FASB ASC 815-10, the total value of these warrants was adjusted to \$110,400 and a loss for the change in value of the liability of \$55,200 was recognized. 100,000 of these warrants were valued in accordance with FASB ASC 815-10 as liabilities using a Monte Carlo Simulation Model as of January 28, 2016. The fair value of the warrant liability on the issuance date for the warrants to be issued was \$56,000 which was recorded as warrant issuance costs. As of March 31, 2016, pursuant to a new valuation performed in accordance with FASB ASC 815-10, the total value of these warrants was adjusted to \$126,000 and a gain for the change in value of the liability of \$40,400 was recognized. As of June 30, 2016, pursuant to a new valuation performed in accordance with FASB ASC 815-10, the total value of these warrants was adjusted to \$237,000 and a loss for the change in value of the liability of \$111,000 was recognized.

Table of Contents*Note 10 – Commitments and Contingencies*

As discussed in Note 6, the Company has entered in an "Exclusive Patent and Know-How License Agreement Including Transfer of Ownership" that requires minimum license maintenance costs. The Company is planning on using the intellectual property granted by the patents for the foreseeable future. The license agreement is considered expired on October 14, 2025, the date the patent expires. Future minimum maintenance fee payments are as follows:

<b>For the twelve months ended June 30</b>	
2017	\$ 300,000
2018	300,000
2019	300,000
2020	300,000
2021	300,000
Thereafter	1,300,000
	<b>\$ 2,800,000</b>

The Company has the option to pay \$2,500,000 and issue 925,000 shares of common stock for the assignment of the patents, and upon doing so, the requirement to make minimum license maintenance costs ends.

*Property Leases*

On June 1, 2011, the Company entered into a lease for warehouse space in Centralia, Washington, commencing August 1, 2011. The lease is currently operating on a month to month basis. Rent is \$1,900 monthly throughout the term of the lease.

On January 27, 2015, the Company entered into a 13-month lease for office space in Lewis Center, Ohio, commencing February 1, 2015. The lease provides for the option to extend the lease for up to five additional years. Rent was abated for the first month of the lease. Rent is \$1,378 per month for months two through thirteen. This lease was renewed for 12 months in November 2015. Rent is \$1,396 for months for months fourteen through twenty-five.

On July 1, 2015, the Company entered into a five year lease for warehouse space in Corsicana, Texas. Rent is \$3,750 monthly throughout the term of the lease and is waived from July 1, 2016 through September 30, 2016.

On September 1, 2015, the Company entered into a three year lease for office space in Grand Forks, North Dakota. Rent is \$3,500 monthly for the first year and decreases to \$2,500 throughout the remainder of the term of the lease.

Table of Contents

Future minimum lease payments under these non-cancelable leases are approximately as follows:

<b>For the twelve months ended June 30,</b>	
2017	\$ 77,000
2018	75,000
2019	50,000
2020	45,000
Thereafter	-
	\$ 247,000

Rent expense was approximately \$70,000 and \$64,000 for the six months ended June 30, 2016 and 2015, respectively.

*Fixed Price Contract*

The Company's multi-year contracts with its commercial customers contain fixed prices for product. These contracts expire through 2019 and expose the Company to the potential risks associated with rising material costs during that same period. The Company has entered into long-term contracts for the supply of certain materials through 2017 to offset the impact of potential raising material costs.

*Note 11 – Equity*

The Company was established with two classes of stock, common stock – 150,000,000 shares authorized at a par value of \$0.001 and preferred stock – 2,000,000 shares authorized at a par value of \$0.001.

*Common Stock*

On January 1, 2016, the Company issued 164,500 shares of common stock to the holders of notes with a term of three years, bear interest at 10% per annum, and are convertible into one share of common stock, par value \$0.001 per share, with the initial conversion ratio equal to \$0.50 per share, as payment for accrued interest due as of December 31, 2015.

***Note 12 - Stock Based Compensation***

On January 10, 2014, the Board of Directors of the Company approved and adopted, subject to stockholder approval, which was obtained at the annual stockholders meeting held on November 16, 2014, the Midwest Energy Emissions Corp. 2014 Equity Incentive Plan (the "Equity Plan"). The number of shares of the Company's Common Stock that may be issued under the Equity Plan is 2,500,000 shares, subject to the adjustment for stock dividends, stock splits, recapitalizations and similar corporate events. Eligible participants under the Equity Plan shall include officers, employees of or consultants to the Company or any of its subsidiaries, or any person to whom an offer of employment is extended, or any person who is a non-employee director of the Company. On October 9, 2014, the Board of Directors approved and adopted the First Amendment to the plan, subject to stockholder approval, which was obtained at the annual stockholders meeting held on November 18, 2014, which increased the number of shares issuable under the plan to 7,500,000.

The Company accounts for stock-based compensation awards in accordance with the provisions of ASC 718, which addresses the accounting for employee stock options which requires that the cost of all employee stock options, as well as other equity-based compensation arrangements, be reflected in the consolidated financial statements over the vesting period based on the estimated fair value of the awards.

Table of Contents

A summary of stock option activity for the quarter ended June 30, 2016 is presented below:

	<b>Number of Shares</b>	<b>Weighted Average Exercise Price</b>	<b>Weighted Average Remaining Contractual Life (years)</b>	<b>Aggregate Intrinsic Value</b>
December 31, 2014	5,095,458	1.70	4.5	-
Grants	2,150,000	0.55	4.6	-
Cancellations	(525,000)	-	-	-
December 31, 2015	6,720,458	1.35	3.7	-
Grants	725,000	0.48	5.0	-
Cancellations	(165,000)	-	-	-
June 30, 2016	7,280,458	1.24	3.5	-
Options exercisable at:				
December 31, 2015	3,705,458	1.81	3.2	
June 30, 2016	3,255,458	2.09	3.2	

The Company utilized the Black-Scholes options pricing model. The significant assumptions utilized for the Black Scholes calculations consist of an expected life of equal to the expiration term of the option, historical volatility of 74.9%, and a risk free interest rate of 3%.

On November 16, 2014, the Company entered into an employment agreement with John Pavlish which terms include the issuance of stock options for the purchase of shares of the Company's common stock in the aggregate amount of three million shares, two million of which was issued on November 16, 2014 and one million of which would be issued on November 16, 2015, in each case pursuant to the terms of the Company's 2014 Equity Incentive Plan. The options granted are exercisable at \$0.74 and \$0.45 per share, respectively, representing the fair market value of the common stock as of the date of grant. These options are to vest two years after the original grant date, subject to his continued employment. Based on a Black-Sholes valuation model, the value of the issued options was \$910,350 and \$200,360, respectively, in accordance with FASB ASC Topic 718. Compensation expense for the quarters ended June 30, 2016 and 2015 on the issued options was \$163,885 and \$113,794, respectively. Compensation expense for the six months ended June 30, 2016 and 2015 on the issued options was \$327,769 and \$227,587, respectively.

On January 1, 2015, the Company granted nonqualified stock options to acquire 250,000 shares of the Company's common stock to Nick Lentz. The options granted are exercisable at \$0.61 per share, representing the fair market value of the common stock as of the date of grant. These options are to vest two years after the original grant date, subject to his continued employment, are exercisable as of the date of vesting and will expire five years thereafter.

Edgar Filing: Midwest Energy Emissions Corp. - Form 10-Q

Based on a Black-Sholes valuation model, these options were valued at \$93,803 in accordance with FASB ASC Topic 718. Compensation expense for the quarter ended June 30, 2016 and 2015 on the issued options was and \$11,724 and \$11,724, respectively. Compensation expense for the six months ended June 30, 2016 and 2015 on the issued options was and \$23,448 and \$23,459, respectively



Table of Contents

On May 1, 2015, the Company issued nonqualified stock options to acquire 25,000 shares each of the Company's common stock to Chris Greenberg, Jay Rifkin and Brian Johnson, each then a director of the Company, under the Company's Equity Plan. Messrs. Greenberg and Johnson remain directors of the Company. The options granted are exercisable at \$0.67 per share, representing the fair market value of the common stock as of the date of the grant as determined under the Equity Plan. These options are to vest one year after the original grant date, subject to continuing service to the Company, are exercisable as of the date of vesting and will expire five years thereafter. Based on a Black-Sholes valuation model, these options were valued at \$30,909 in accordance with FASB ASC Topic 718. On November 9, 2015, Jay Rifkin resigned as a director of the Company, and his stock option was terminated.

On May 1, 2016, the Company issued nonqualified stock options to acquire 25,000 shares each of the Company's common stock to Christopher Greenberg, Brian Johnson and Christopher Lee, current directors of the Company, under the Company's Equity Plan. The options granted are exercisable at \$0.42 per share, representing the fair market value of the common stock as of the date of the grant as determined under the Equity Plan. These options are to vest one year after the original grant date, subject to continuing service to the Company, are exercisable as of the date of vesting and will expire five years thereafter. Based on a Black-Sholes valuation model, these options were valued at \$19,763 in accordance with FASB ASC Topic 718.

On June 1, 2016, the Company granted nonqualified stock options to acquire 250,000 shares of the Company's common stock to Patrick Mongovan. The options granted are exercisable at \$0.42 per share, representing the fair market value of the common stock as of the date of grant. These options are fully vested and are exercisable as of the date of the grant and will expire five years thereafter. Based on a Black-Sholes valuation model, these options were valued at \$28,836 in accordance with FASB ASC Topic 718.

On June 30, 2016, the Company issued nonqualified stock options to acquire 125,000 shares of the Company's common stock to Christopher Greenberg, nonqualified stock options to acquire 75,000 shares of the Company's common stock to Christopher Lee, and nonqualified stock options to acquire 50,000 shares of the Company's common stock to each of Brian Johnson and Allan Grantham, current directors of the Company, under the Company's Equity Plan. The options granted are exercisable at \$0.42 per share, representing the fair market value of the common stock as of the date of the grant as determined under the Equity Plan. These options are fully vested and are exercisable as of the date of the grant and will expire five years thereafter. Based on a Black-Sholes valuation model, these options were valued at \$174,902 in accordance with FASB ASC Topic 718.

On June 30, 2016, the Company issued nonqualified stock options to acquire 250,000 shares of the Company's common stock to Richard MacPherson, CEO and a current director of the Company, under the Company's Equity Plan. The options granted are exercisable at \$0.42 per share, representing the fair market value of the common stock as of the date of the grant as determined under the Equity Plan. These options are to vest after such time that the closing price of the Company's common stock is equal to or in excess of \$0.80 per share for any consecutive 30 day trading period following the grant date and will expire five years after the date of the grant. Based on a Black-Sholes valuation model, these options were valued at \$145,752 in accordance with FASB ASC Topic 718.

*Note 13 - Warrants*

Unless sold and issued warrants are subject to the provisions of FASB ASC 815-10, the Company utilized a Black-Scholes options pricing model to value the warrants sold and issued. This model requires the input of highly subjective assumptions such as the expected stock price volatility and the expected period until the warrants are exercised. When calculating the value of warrants issued, the Company uses a volatility factor of 74.9%, a risk free interest rate and the life of the warrant for the exercise period. When sold and issued warrants were valued in accordance with FASB ASC 815-10, the fair value was determined using a Monte Carlo Simulation Model.

Table of Contents

On March 16, 2015, the Companies entered into a Waiver and Amendment to Financing Agreement, and Reaffirmation of Guaranty (the "Amendment") with the Lender. Pursuant to the Amendment, the exercise price of the five year warrant previously issued to the Lender to purchase up to 12,500,000 shares of common stock was decreased to \$0.50 per share, subject to adjustment in a manner similar to the adjustments on the Note.

On November 16, 2015, in connection with entering into Amendment No. 2 with the Lender, the Company issued a five year contingent warrant to the Lender to purchase up to 5,000,000 shares of common stock with an exercise price of \$0.35 per share, subject to adjustment in a manner similar to the adjustments on the New Notes, which warrant shall be immediately exercisable for 3,600,000 shares with the balance of 1,400,000 shares exercisable proportionately to such additional Senior Convertible Notes up to \$1,400,000 purchased by the Lender as described Note 7. At issuance of this warrant, the Lender shall be entitled upon any exercise of the warrant to a number of shares of common stock in an amount at least equal to 4.32% of the aggregate number of then-outstanding shares of capital stock of the Company (as determined on a fully-diluted basis). In addition, if the aggregate number of Warrant Shares purchasable under the Warrant calculated at the time of the initial exercise of the Warrant is less than 4.32% of the outstanding shares of capital stock of the Company at the time of the initial exercise of the Warrant, the Lender's number of Warrant Shares shall be increased by an amount of shares necessary to cause the number of Warrant Shares to represent 4.32% of the aggregate number of then-outstanding shares of capital stock of the Company on a fully diluted basis. The Warrant can be converted to shares of common stock through a cashless exercise at the option of the Lender.

On January 28, 2016, Under the Third Amended Financing Agreement, and in consideration for the issuance of the Letter of Credit, the Company has agreed to issue to Lender (i) a five year warrant to purchase 2,000,000 shares of common stock at an exercise price of \$0.35 per share of common stock (the "Third Warrant"), and (ii) a Senior Secured Letter of Credit Note (the "LC Note") to evidence any indebtedness owed by the Company arising from any draws made under the Letter of Credit. The Third Warrant shall be subject to certain anti-dilution adjustments including percentage based anti-dilution protection requiring that the aggregate number of shares of common stock purchasable upon its initial exercise not be less than an amount equal to 7.2% of the Company's then outstanding shares of capital stock on a fully diluted basis.

On February 16, 2016, the Company entered into a 2013 Noteholder Modification Agreement (the "Noteholder Modification Agreement") with each of the investors (through their designated Note Agent) of certain secured promissory notes issued by the Company in 2013 (the "2013 Secured Notes"). Such 2013 Secured Notes contain a most favored nations clause ("MFN") which provides that following the Company's completion of an equity or equity-linked new financing (each a "New Financing"), the Company shall provide each of the holders of the 2013 Secured Notes (the "Holders") written notice thereof and a 60 day period in which to exchange the 2013 Secured Notes at a value equal to the outstanding principal balance plus accrued outstanding interest into the same securities as issued in the New Financing. Pursuant to the Noteholder Modification Agreement, which was entered into in order to resolve the differences between the parties as to the applicability of the MFN provision to the Second Amended Financing Agreement, the Company (i) agreed that the exercise price for each share of common stock purchasable with respect to the 2013 Warrants held by currently outstanding Holders be reduced to \$0.35 per share of common stock (resulting in the exercise price being reduced for 2013 Warrants exercisable for 3,290,000 shares), and (ii)

agreed to issue to such currently outstanding Holders of 2013 Secured Notes in the aggregate warrants to purchase up to 1,600,000 shares of common stock at \$0.35 per share, exercisable at any time on or before November 15, 2020. In addition, the Noteholder Modification Agreement provided additional carveouts to the applicability of the MFN provision to certain other transactions in the future as described therein. The warrants are fully vested and exercisable as of the date of grant and will expire five year thereafter. Based on a Black-Sholes valuation model, these options were valued at \$495,394 in accordance with FASB ASC Topic 718 and this cost was recorded as settlement charge expense during the year ended December 31, 2015. These warrants are not included in the table of outstanding common stock warrants below.

On February 19, 2016, the Company issued to Drexel pursuant to an amendment to its engagement agreement a 5-year warrant to purchase up to 300,000 shares of common stock at \$0.35 per share. The warrant is subject to adjustments similar to the Warrant issued to the Lender on November 16, 2014. Approximately 200,000 of these warrants were owed to Drexel as of December 31, 2015 for services rendered. Also pursuant to this agreement, the exercise price on all warrants issued to Drexel on November 16, 2014 was reset to \$0.35 per share.

On April 26, 2016, pursuant to a consulting agreement executed on that date, the Company granted MZHCI, LLC, a vested warrant with a term of three years to purchase 75,000 shares of common stock with an exercise price of \$0.65 per share. Per the terms of the agreement, the Company will issue MZHCI, LLC an additional warrant to purchase 75,000 shares of common stock with an exercise price of \$0.90 per share 91 days after the effective date of the agreement. These warrants will each include a cashless exercise provision. Based on a Black-Sholes valuation model, the warrants issued on April 26, 2016 were valued at \$19,240 in accordance with FASB ASC Topic 718.

Table of Contents

The following table summarizes information about common stock warrants outstanding at June 30, 2016:

Exercise Price	Outstanding			Exercisable		
	Number Outstanding	Weighted Average Remaining Contractual Life (years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price	Weighted Average Exercise Price
1.25	11,195	0.53	1.25	11,195	1.25	1.25
1.00	1,642,680	0.94	1.00	1,642,680	1.00	1.00
0.87	1,303,300	2.86	0.87	1,303,300	0.87	0.87
0.65	590,000	2.65	0.65	590,000	0.65	0.65
0.50	12,743,728*	3.12	0.50	12,743,728	0.50	0.50
0.48	577,750	2.27	0.48	577,750	0.48	0.48
0.35	12,787,087*	3.71	0.35	12,787,087	0.35	0.35
\$0.50 - \$3.30	29,655,740	3.22		29,655,740		

Note \* All warrants exercisable at \$0.50 and 7,897,093 warrants exercisable at \$0.35 contain dilution protections that increase the number of shares purchasable at exercise upon the issuance of securities at a price below the current exercise price.

**Note 14 – Tax**

For the quarter ended June 30, 2016, the Company had a net operating loss carryforward offset by a valuation allowance and, accordingly, no provision for income taxes has been recorded. In addition, no benefit for income taxes has been recorded due to the uncertainty of the realization of any tax assets. At December 31, 2015, the Company's net operating loss carryforward was approximately \$24,421,000. Our deferred tax asset primarily related to accrued compensation and net operating losses. A 100% valuation allowance has been established due to the uncertainty of the utilization of these assets in future periods. As a result, the deferred tax asset was reduced to zero and no income tax benefit was recorded. The net operating loss carryforward, if not utilized, will begin to expire in 2031.

Section 382 of the Internal Code allows post-change corporations to use pre-change net operating losses, but limit the amount of losses that may be used annually to a percentage of the entity value of the corporation at the date of the ownership change. The applicable percentage is the federal long-term tax-exempt rate for the month during which the change in ownership occurs.

***Note 15 – Subsequent Events***

On July 1, 2016, the Company issued 164,500 shares of common stock to the holders of notes with a term of three years, bear interest at 10% per annum, and are convertible into one share of common stock, par value \$0.001 per share, with the initial conversion ratio equal to \$0.50 per share, as payment for accrued interest due as of June 30, 2016.

On August 1, 2016, AC Midwest Energy LLC deferred the principal payment due of \$720,898 per the terms of the Financing Agreement until the note maturity date on July 31, 2018. This amount will be added to principal and will bear interest during this period.

On August 3, 2016, the Company issued 15,181 shares of common stock upon the cashless exercise of warrants to purchase 22,458 shares of common stock for \$0.35 per share based on a market value of \$1.08 per share as determined under the terms of the warrant.

Table of Contents

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

**Background**

Midwest Energy Emissions Corp. (the "Company", "we", "us" and "our") develops and deploys patented, proprietary technologies to remove mercury emissions from coal-fired power plants. The U.S. EPA MATS (Mercury and Air Toxics Standards) rule requires that all coal and oil-fired power plants in the U.S., larger than 25MWs, must limit mercury in its emissions to below certain specified levels, according to the type of coal burned. Power plants were required to begin complying with MATS on April 16, 2015, unless they were granted a one-year extension to begin to comply. MATS, along with many state and provincial regulations, form the basis for mercury emission capture at coal fired plants across North America. Under the MATS regulation, Electric Generating Units ("EGUs") are required to remove about 90% of the mercury from their emissions. We believe that we continue to meet the requirements of the industry as a whole and our technologies have been shown to achieve mercury removal levels compliant with all state, provincial and federal regulations at a lower cost and with less plant impact than our competition.

As is typical in this market, we are paid by the EGU based on how much of our material is injected to achieve the needed level of mercury removal. Our current clients pay us as material is delivered to their facility. Clients will use our material whenever their EGUs operate, although EGUs are not always in operation. EGUs typically may not be in operation due to maintenance reasons or when the price of power in the market is less than their cost to produce power. Thus, our revenues from EGU clients will not typically be a consistent stream but will fluctuate, especially seasonally as the market demand for power fluctuates.

The MATS regulation has been subject to legal challenge, and in June 2015, the U.S. Supreme Court held that the EPA unreasonably failed to consider costs in determining whether to regulate hazardous air pollutants, including mercury, from power plants and remanded the case back to the U.S. Court of Appeals for the District of Columbia Circuit for further proceedings, but left the rule in place. In December 2015, the D.C. Circuit remanded the rule to the EPA for further consideration, without vacatur, allowing MATS to remain in effect until the EPA issues a final finding. On March 18, 2016, 20 states filed a petition for certiorari with the U.S. Supreme Court to review the D.C. Circuit's decision to remand without vacatur the MATS rule to the EPA which petition for certiorari was denied by the U.S. Supreme Court on June 13, 2016. In the meantime, on April 14, 2016, the EPA issued a final supplemental finding upholding the rule and concluding that a cost analysis supports the MATS rule. While the Company expects that the issuance by the EPA of its final finding will keep MATS in effect going forward, the Company is unable to predict with certainty the outcome of any such further proceedings.

We remain focused on positioning the Company for short and long-term growth. In the quarter ended June 30, 2016, we commercialized a new, sorbent enhancement additive and increased our production capability to offer this product

in bulk quantities. We believe this product to be a key product in our growth strategy. We continue to make refinements to all of our key products, as we continue to focus on the customer and its operations. We also hired a new regional sales manager to cover the U.S Midwest and continued to expand our employee base as we plan for future growth. As described below, we achieved substantial increases in revenues compared to the prior year. We ended the second quarter of 2016 with 20 fully operational MATS compliant EGU's utilizing our technologies. We expect revenue growth throughout the rest of 2016 and beyond.



Table of Contents

**Results of Operations**

The second fiscal quarter of 2016 was a quarter of continued revenue growth and business plan execution. During the quarter, the Company completed the commissioning of its largest equipment project to date and saw its entire customer base begin their MATS compliance activities. During the quarter, the Company had long terms contracts on 19 EGU's and a short term compliance contract on one EGU. All of these customer EGU's are now complying with MATS as those with one year compliance extensions, saw those extensions expire in April 2016. The compliance efforts of our customer base resulted in exponential sales growth over the same period last year and positive cash flow from operations.

**Revenues**

*Sales* - We generated revenues of approximately \$9,392,000 and \$2,697,000 for the quarters ended June 30, 2016 and 2015, respectively and \$12,766,000 and \$2,940,000 for the six months ended June 30, 2016 and 2015, respectively. Total sorbent product sales for the three months ended June 30, 2016 and 2015 were \$6,872,000 and \$609,000, respectively. Total sorbent product sales for the six months ended June 30, 2016 and 2015 were \$9,710,000 and \$853,000, respectively. These increases from the prior year were associated with the MATS compliance activities of our customers, which began in April 2016, with our all customers in operation by the end of the period.

Equipment sales for the three months ended June 30, 2016 and 2015 were \$2,391,000 and \$1,967,000, respectively. Equipment sales for the six months ended June 30, 2016 and 2015 were \$2,556,000 and \$1,967,000, respectively. Equipment sales during 2016 are primarily related to the commissioning of one customer project that included both a front end and back end product injection systems. In 2015, equipment sales were primarily related to three front end injection systems.

Other revenues for the three months ended June 30, 2016 and 2015 were \$129,000 and \$120,000, respectively. Other revenues for the six months ended June 30, 2016 and 2015 were \$500,000 and \$120,000, respectively. This increase is primarily associated with increased demonstration revenues in the three months ended March 31, 2016 from the same period in the prior year.

**Cost and Expenses**

*Costs and expenses* were \$8,972,000 and \$3,387,000 during the three months ended June 30, 2016 and 2015, respectively, and were \$12,630,000 and \$4,876,000 for the six months ended June 30, 2016 and 2015, respectively. The increase in costs and expenses from the prior year is primarily attributable to an increase in costs of sales during the current quarter compared to the same period in the prior year. These increases are primarily associated with the significant increase in revenues in the quarter ended June 30, 2016.

*Cost of sales* during the three months ended June 30, 2016 and 2015 was \$7,304,000 and \$2,334,000, respectively, and were \$9,792,000 and \$2,841,000 for the six months ended June 30, 2016 and 2015, respectively. The increase in cost is primarily attributable to the significant increase in product sales in 2016. Direct product costs during the three months ended June 30, 2016 and 2015 was \$3,877,000 and \$347,000, respectively, and were \$5,506,000 and \$497,000 for the six months ended June 30, 2016 and 2015, respectively.

## Table of Contents

Equipment cost of sales during the three months ended June 30, 2016 and 2015 was \$2,384,000 and \$1,377,000, respectively, and were \$2,506,000 and \$1,377,000 for the six months ended June 30, 2016 and 2015, respectively. The decrease in margin on equipment sales in 2016 is primarily attributable to the large project that was completed in the quarter ended June 30, 2016, which was subcontracted to a third party. The Company also had increases in license costs, overhead and depreciation and amortization during the three and six months ended June 30, 2016 from the same periods in 2015 due to the increase in business operations as its customers began MATS compliance activities in 2016.

*Selling, general and administrative expenses* were \$1,668,000 and \$1,053,000 for the quarters ended June 30, 2016 and 2015, respectively, and were \$2,838,000 and \$2,035,000 for the six months ended June 30, 2016 and 2015, respectively. The increase in selling, general and administrative expenses is primarily attributed increases in sales commissions and stock based compensation associated with stock options issued to officers, directors and employees.

## **Other Expenses**

Interest expense related to the financing of capital was \$1,033,000 and \$936,000 during the quarters ended June 30, 2016 and 2015, respectively, and were \$3,106,000 and \$4,358,000 for the six months ended June 30, 2016 and 2015, respectively. In connection with change in the conversion terms and repayment of principal during the quarter ended March 31, 2015, per the Amendment with AC Midwest Energy, LLC, the Company incurred a loss of \$2,246,000 which was primarily related to accelerated amortization of the discount on convertible notes payable and is included in interest expense during that period. During the quarter ended March 31, 2016, The Company incurred a charge of \$1,125,000 related to warrants issued in connection with the issuance of a letter of credit which was included in interest expense. During the quarters ended June 30, 2016 and 2015, a loss of \$7,566,000 and a gain of \$3,195,000, respectively, on the change in value of warrant liability was recorded. During the six months ended June 30, 2016 and 2015, a loss of \$4,257,000 and a gain of \$1,317,000, respectively, on the change in value of warrant liability was recorded.

## **Net Income (Loss)**

For the quarter ended June 30, 2016 we had a net loss of approximately \$8,243,000. For the quarter ended June 30, 2015, we had net income of approximately \$599,000. For the six months ended June 30, 2016 and 2015 we had a net loss of \$7,335,000 and \$5,968,000, respectively. The decreased income for these periods is primarily attributed to loss on the change in value of warrant liability and is offset by (i) increased operating income, and; (ii) debt conversion costs incurred in 2015.

## **Taxes**

As of June 30, 2016, our deferred tax assets are primarily related to accrued compensation and net operating losses. A 100% valuation allowance has been established due to the uncertainty of the utilization of these assets in future periods. As a result, the deferred tax asset was reduced to zero and no income tax benefit was recorded. The net operating loss carryforward will begin to expire in 2031.

Section 382 of the Internal Code allows post-change corporations to use pre-change net operating losses, but limit the amount of losses that may be used annually to a percentage of the entity value of the corporation at the date of the ownership change. The applicable percentage is the federal long-term tax-exempt rate for the month during which the change in ownership occurs.

Table of Contents**Non-GAAP Financial Measures***Adjusted EBITDA*

To supplement our consolidated financial statements presented in accordance with GAAP and to provide investors with additional information regarding our financial results, we consider and are including herein Adjusted EBITDA, a Non-GAAP financial measure. We view Adjusted EBITDA as an operating performance measure and, as such, we believe that the GAAP financial measure most directly comparable to it is net income (loss). We define Adjusted EBITDA as net income adjusted for income taxes, depreciation, amortization, stock based compensation, and other non-cash income and expenses. We believe that Adjusted EBITDA provides us an important measure of operating performance because it allows management, investors, debtholders and others to evaluate and compare ongoing operating results from period to period by removing the impact of our asset base, any asset disposals or impairments, stock based compensation and other non-cash income and expense items associated with our reliance on issuing equity-linked debt securities to fund our working capital.

Our use of Adjusted EBITDA has limitations as an analytical tool, and this measure should not be considered in isolation or as a substitute for an analysis of our results as reported under GAAP, as the excluded items may have significant effects on our operating results and financial condition. Additionally, our measure of Adjusted EBITDA may differ from other companies' measure of Adjusted EBITDA. When evaluating our performance, Adjusted EBITDA should be considered with other financial performance measures, including various cash flow metrics, net income and other GAAP results. In the future, we may disclose different non-GAAP financial measures in order to help our investors and others more meaningfully evaluate and compare our future results of operations to our previously reported results of operations.

We prepare and publicly release quarterly unaudited financial statements prepared in accordance with GAAP. The following table shows our reconciliation of Net Income to Adjusted EBITDA for the quarters and six months ended June 30, 2016 and 2015, respectively:

	Quarter Ended June 30,		Six Months Ended June	
	2016	2015	2016	2015
	(in thousands)		(in thousands)	
Net (loss) income	\$ (8,243)	\$ 599	\$ (7,335)	\$ (5,968)
Non-GAAP adjustments:				
Depreciation and amortization	229	99	393	165

Edgar Filing: Midwest Energy Emissions Corp. - Form 10-Q

Interest	1,033	936	3,106	4,358
State income taxes	3	8	4	28
Stock based compensation	404	206	583	332
Change in warrant liability	7,566	(3,195)	4,257	(1,316)
Debt conversion costs	-	962	-	962
Adjusted EBITDA	\$ 992	\$ (385)	\$ 1,008	\$ (1,439)

Table of Contents

We are including below our unaudited reconciliation of Net Income to Adjusted EBITDA on a quarterly basis for the quarters ended September 30, 2015, December 31, 2015, March 31, 2016 and June 30, 2016:

	<b>Quarter Ended (Unaudited)</b>			
	<b>6/30/2016</b>	<b>3/31/2016</b>	<b>12/31/2015</b>	<b>9/30/2015</b>
	<b>(in thousands)</b>			
Net (loss) income	\$ (8,243)	\$ 908	\$ (7,138)	\$ (1,155)
<b>Non-GAAP adjustments:</b>				
Depreciation and amortization	229	164	123	103
Interest	1,033	2,073	950	906
State income taxes	3	1	5	8
Stock based compensation	404	179	177	280
Change in warrant liability	7,566	(3,309)	4,655	(145)
Settlement charges	-	-	1,335	-
Debt conversion costs	-	-	-	161
Adjusted EBITDA	\$ 992	\$ 16	\$ 107	\$ 158

**Liquidity and Capital Resources**

Our principal source of liquidity is cash generated from operating activities. As of June 30, 2016, our cash and cash equivalents totaled \$619,000. Although we anticipate significant revenues from the sale of products to be used in MATS compliance by customers to continue in 2016 and beyond, no assurances can be given that the Company can obtain sufficient working capital through operating activities to meet its debt obligations as they come due. We anticipate generating significant cash flows during 2016, subject to achieving our projected level of sales with our expected gross margins. No assurance can be made that we will be able to achieve the expected results..

*Total assets* were \$8,711,000 at June 30, 2016 versus \$7,315,000 at December 31, 2015. The change in total assets is primarily attributable to the increases in accounts receivable and property and equipment and is offset by the decrease in inventory.

*Total liabilities* were \$28,304,000 at June 30, 2016 versus \$20,260,000 at December 31, 2015. During the six months ended June 30, 2016, the fair value of the Company's warrant liability increased significantly. Also during this period there was an increase in current operating liabilities associated with the increased sales operations during the period.

*Operating activities* provided \$457,000 of cash during the quarter ended June 30, 2016 compared to using \$2,594,000 during the six months ended June 30, 2015. The change in cash used for operating activities is primarily attributable to the increase in revenues and gross margin during the six months ended June 30, 2016.

*Investing activities* used \$908,000 and \$660,000 during the six months ended June 30, 2016 and 2015, respectively. In 2016 and 2015, additions of property and equipment associated with the expansion of our operations in preparation for MATS compliance activities of our customers were responsible for these expenditures.

*Financing activities* used \$3,000,000 during the six months ended June 30, 2015 due to the repayment of principal of convertible promissory notes. Payments on equipment notes payable used \$13,000 for the six months ended June 30, 2016.



Table of Contents

**Off-Balance Sheet Arrangements**

We do not have any off balance sheet arrangements that are reasonably likely to have a current or future effect on our financial condition, revenues, and results of operations, liquidity or capital expenditures.

**Critical Accounting Policies and Estimates**

Our discussion and analysis of our financial conditions and results of operation are based upon the accompanying consolidated financial statements which have been prepared in accordance with the generally accepted accounting principles in the U.S. The preparation of the consolidated financial statements requires that we make estimates and assumptions that affect the amounts reported in assets, liabilities, revenues and expenses. Management evaluates on an on-going basis our estimates with respect to the valuation allowances for accounts receivable, income taxes, accrued expenses and equity instrument valuation, for example. We base these estimates on various assumptions and experience that we believe to be reasonable. The following critical accounting policies are those that are important to the presentation of our financial condition and results of operations. These policies require management's most difficult, complex, or subjective judgments, often as a result of the need to make estimates of matters that are inherently uncertain.

The following critical accounting policies affect our more significant estimates used in the preparation of our consolidated financial statements. In particular, our most critical accounting policies relate to the recognition of revenue, and the valuation of our stock-based compensation.

**Going Concern**

The accompanying consolidated financial statements as of June 30, 2016 have been prepared assuming the Company will continue as a going concern. Since its inception, the Company has experienced recurring losses and has an accumulated deficit of \$45,335,000. The Company has current convertible notes payments due of \$4,042,000. These principal payments raise doubt about the Company's ability to continue as a going concern. Although we anticipate significant revenues and cash generation from sales of products to be used in MATS compliance activities, no assurances can be given that the Company can obtain sufficient working capital through these activities to meet its debt obligations. Due to certain covenants with our senior lender, we are not able to use current cash on hand to pay current convertible note holders as these notes mature. Success in our ongoing operations and continued negotiations with our note holders is critical. We will actively seek sources of additional financing in order to fund our debt repayment obligations if extensions cannot be negotiated with our early investors who purchased convertible debt from the Company. No assurances can be given that the Company can maintain sufficient working capital through

these efforts or that the continued implementation of its business plan will generate sufficient revenues in the future to sustain ongoing operations.

The accompanying consolidated financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classifications of liabilities that may result from the possible inability of the Company to continue as a going concern.

### **Accounts Receivable**

Trade accounts receivable are stated at the amount the Company expects to collect. The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. Management considers the following factors when determining the collectability of specific customer accounts: customer credit-worthiness, past transaction history with the customer, current economic industry trends, and changes in customer payment terms. Past due balances over 90 days and other higher risk amounts are reviewed individually for collectability. If the financial condition of the Company's customers were to deteriorate, adversely affecting their ability to make payments, additional allowances would be required. Based on management's assessment, the Company provides for estimated uncollectible amounts through a charge to earnings and a credit to a valuation allowance. Balances that remain outstanding after the Company has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to accounts receivable.

Table of Contents

**Revenue Recognition**

The Company records revenue from sales in accordance with ASC 605, *Revenue Recognition* ("ASC 605"). The criteria for recognition are as follows:

1. Persuasive evidence of an arrangement exists;
2. Delivery has occurred or services have been rendered;
3. The seller's price to the buyer is fixed or determinable; and
4. Collectability is reasonably assured.

Determination of criteria (3) and (4) will be based on management's judgments regarding the fixed nature of the selling prices of the products delivered and the collectability of those amounts. Provisions for discounts and rebates to customers, estimated returns and allowances, and other adjustments will be provided for in the same period the related sales are recorded.

**Income Taxes**

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the consolidated financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets, including tax loss and credit carryforwards, and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Deferred income tax expense represents the change during the period in the deferred tax assets and deferred tax liabilities. The components of the deferred tax assets and liabilities are individually classified as current and non-current based on their characteristics. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

The recognition, measurement and disclosure of uncertain tax positions recognized in an enterprise's consolidated financial statements are based on a more-likely-than-not recognition threshold. The Company did not have any unrecognized tax benefits at June 30, 2016 and December 31, 2015. When necessary, the Company would accrue penalties and interest related to unrecognized tax benefits as a component of income tax expense.

The Company and its subsidiaries file a consolidated income tax return in the U.S. federal jurisdiction and three state jurisdictions. The Company is no longer subject to U.S. federal examinations for years prior to 2012 or state tax examinations for years prior to 2011.

Table of Contents

**Stock-Based Compensation**

We have adopted the provisions of *Share-Based Payments*, which requires that share-based payments be reflected as an expense based upon the grant-date fair value of those grants. Accordingly, the fair value of each option grant, non-vested stock award and shares issued under our employee stock purchase plan, were estimated on the date of grant. We estimate the fair value of these grants using the Black-Scholes model which requires us to make certain estimates in the assumptions used in this model, including the expected term the award will be held, the volatility of the underlying common stock, the discount rate, dividends and the forfeiture rate. The expected term represents the period of time that grants and awards are expected to be outstanding. Expected volatilities were based on historical volatility of our stock. The risk-free interest rate approximates the U.S. treasury rate corresponding to the expected term of the option. Dividends were assumed to be zero. Forfeiture estimates are based on historical data. These inputs are based on our assumptions, which we believe to be reasonable but that include complex and subjective variables. Other reasonable assumptions could result in different fair values for our stock-based awards. Stock-based compensation expense, as determined using the Black-Scholes option-pricing model, is recognized on a straight-line basis over the service period, net of estimated forfeitures. To the extent that actual results or revised estimates differ from the estimates used, those amounts will be recorded as an adjustment in the period that estimates are revised.

**Warrant Liability**

On August 14, 2014, Company issued the Lender a warrant to purchase 12,500,000 shares of the Company's common stock at \$1.00 per share, subject to the adjustments (see Note 13 for changes to the terms of these warrants). The Company also issued to Drexel for the transaction: (i) a 5-year warrant to purchase up to 800,000 shares of common stock at \$1.00 per share; and (ii) a 5-year warrant to purchase up to 1,000,000 shares of common stock at \$0.50 per share, both subject to adjustments similar to the Warrant issued to the Lender (see Note 13 for changes to the terms of these warrants).

On November 16, 2015, Company issued the Lender a contingent warrant to purchase up to 5,000,000 shares of the Company's common stock at \$0.35 per share, subject to adjustments, which warrant shall be immediately exercisable for 3,600,000 shares with the balance of 1,400,000 shares exercisable proportionately to such additional Senior Convertible Notes up to \$1,400,000 purchased by the Lender (see Note 13 for the terms of these warrants).

On January 28, 2016, in consideration for the issuance of the Letter of Credit, the Company has agreed to issue to Lender (i) a five year warrant to purchase 2,000,000 shares of common stock, subject to certain anti-dilution adjustment provisions at an exercise price of \$0.35 per share of common stock.

On February 19, 2016, in connection to Amendment No. 2 and Amendment No. 3, the Company issued Drexel: a 5-year warrant to purchase up to 300,000 shares of common stock at \$0.35 per share as compensation for services rendered.

These warrants are valued in accordance with FASB ASC 815-10 as liabilities using a Monte Carlo Simulation Model as of each reporting period date and the change in value can have a significant impact on the Company's bottom line. The significant assumptions considered by the model were the remaining term of the warrants, operational forecasts provided by the Company, the fair value per share stock price, a risk free treasury rate and an expected volatility rate at each measurement date.

### **Warrants**

Unless sold and issued warrants are subject to the provisions of FASB ASC 815-10, the Company utilized a Black-Scholes options pricing model to value the warrants sold and issued. This model requires the input of highly subjective assumptions such as the expected stock price volatility and the expected period until the warrants are exercised. When calculating the value of warrants issued, the Company uses a volatility factor of 74.9%, a risk free interest rate and the life of the warrant for the exercise period. When sold and issued warrants were valued in accordance with FASB ASC 815-10, the fair value was determined using a Monte Carlo Simulation Model.

Table of Contents

**ITEM 3 – QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

We are a smaller reporting company as defined by Rule 12b-2 of the Securities Exchange Act of 1934 and are not required to provide the information under this item.

**ITEM 4 – CONTROLS AND PROCEDURES**

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we have evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) and Rule 15d-15(e) of the Exchange Act) as of the end of the period covered by this report. Disclosure controls and procedures are designed to ensure that information required to be disclosed in reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to management, including our principal executive officer and principal financial officer, to allow timely decisions regarding required disclosure. Based on that evaluation, our principal executive officer and principal financial officer concluded, as of the end of the period covered by this report, that the Company's disclosure controls and procedures were not effective as a result of material weaknesses in our internal control over financial reporting. The ineffectiveness of our disclosure controls and procedures was due to the following material weaknesses in our internal control over financial reporting, which are common to many small companies: (i) lack of a sufficient complement of personnel commensurate with the Company's reporting requirements; and (ii) insufficient written documentation or training of our internal control policies and procedures which provide staff with guidance or framework for accounting and disclosing financial transactions.

Despite the existence of the material weaknesses above, we believe that the consolidated financial statements contained in this Form 10-Q fairly present our financial position, results of operations and cash flows as of and for the periods presented in all material respects.

***Changes in Internal Control over Financial Reporting***

There have been no changes in the Company's internal control over financial reporting that occurred during the fiscal quarter covered by this report that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.





Table of Contents

**PART II – OTHER INFORMATION**

**ITEM 1 – LEGAL PROCEEDINGS**

None

**ITEM 1a – RISK FACTORS**

We are a smaller reporting company as defined by Rule 12b-2 of the Securities Exchange Act of 1934 and are not required to provide the information under this item.

**ITEM 2 – UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

None

**ITEM 3 – DEFAULT UPON SENIOR SECURITIES**

Not applicable.

**ITEM 4 – MINE SAFETY DISCLOSURES**

Not applicable.

**ITEM 5 – OTHER INFORMATION**

None

39

Table of Contents

**ITEM – 6 EXHIBITS**

**Exhibit**

**Number Description**

<u>31.1*</u>	<u>Certification by Chief Executive Officer, required by Rule 13a-14(a) or Rule 15d-14(a) of the Exchange Act</u>
<u>31.2*</u>	<u>Certification by Chief Financial Officer, required by Rule 13a-14(a) or Rule 15d-14(a) of the Exchange Act</u>
<u>32.1*</u>	<u>Certification by Chief Executive Officer, required by Rule 13a-14(b) or Rule 15d-14(b) of the Exchange Act and Section 1350 of Chapter 63 of Title 18 of the United States Code</u>
<u>32.2</u>	<u>Certification by Chief Financial Officer, required by Rule 13a-14(b) or Rule 15d-14(b) of the Exchange Act and Section 1350 of Chapter 63 of Title 18 of the United States Code</u>
101*	The following financial information from our Quarterly Report on Form 10-Q for the six months ended June 30, 2016 formatted in Extensible Business Reporting Language (XBRL): (i) the Condensed Consolidated Balance Sheets, (ii) the Condensed Consolidated Statements of Operations, (iii) the Condensed Consolidated Statements of Stockholders' Deficit, (iv) the Condensed Consolidated Statements of Cash Flows, and (v) Notes to Condensed Consolidated Financial Statements

---

\* Filed herewith.

Table of Contents

**SIGNATURES**

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

**MIDWEST ENERGY EMISSIONS  
CORP.**

Dated: August 8, 2016

By: */s/ Richard MacPherson*  
Richard MacPherson  
President and Chief Executive  
Officer  
(Principal Executive Officer)

Dated: August 8, 2016

By: */s/ Richard H. Gross*  
Richard H. Gross  
Chief Financial Officer  
(Principal Financial Officer)