ENVIRONMENTAL POWER CORP
Form 10-Q
November 09, 2009
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark one)

x **QUARTERLY REPORT UNDER SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2009

OR

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

For the transition period from ______ to ______

Commission file number 001-32393

Environmental Power Corporation

(Exact name of registrant as specified in its charter)

Delaware	**75-3117389**
(State or other jurisdiction of incorporation or organization)	**(IRS Employer Identification No.)**

120 White Plains Road, 6th Floor, Tarrytown NY 10591

(address of principal executive offices) (zip code)

(914) 631-1435

(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 x 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 definition of large accelerated filer accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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

Number of shares of Common Stock outstanding at September 30, 2009: 15,708,591 shares

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

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PART I. FINANCIAL INFORMATION

Cautionary Statement Regarding Forward-Looking Statements

The Private Securities Litigation Reform Act of 1995, referred to as the PSLRA, provides a safe harbor for forward-looking statements. Certain statements contained or incorporated by reference in this Quarterly Report, such as statements concerning planned manure-to-energy systems, our sales pipeline, our backlog, our projected sales and financial performance, statements containing the words may, assumes, forecasts, positions, predicts, strategy, will, expects, estimates, anticipates, believes, projects, intends, plans, budgets, potential, variations thereof, and other statements contained in this Quarterly Report regarding matters that are not historical facts are forward-looking statements as such term is defined in the PSLRA. Because such statements involve risks and uncertainties, actual results may differ materially from those expressed or implied by such forward-looking statements. Factors that could cause actual results to differ materially include, but are not limited to:

- uncertainties involving early-stage companies, including our need for additional financing to continue as a going concern,
- uncertainties regarding the ability to obtain additional financing, and the timing, amount and terms of such financing,
- the lack of binding commitments and the need to negotiate and execute definitive agreements for the construction and financing of facilities,
- the lack of binding commitments for the purchase of gas produced by certain facilities,
- the lack of binding commitments for, and other uncertainties with respect to, supplies of substrate,
- uncertainties regarding the costs associated with substrate and other project inputs,
- risks and uncertainties relating to the development of markets for carbon sequestration credits and other marketable renewable attributes, and the level of revenues we may achieve from such sources,
- uncertainties regarding the amount and rate of growth in operating expenses,
- unpredictable developments, including plant outages and repair requirements as well as risks related to weather and the unpredictability of extreme weather events,
- risks related to performance on the part of suppliers of components, goods and services to our facilities,
- financing and cash flow requirements and uncertainties,
- inexperience with the design, construction, startup and operation of multi-digester facilities,

- difficulties involved in developing and executing a business plan,
- technological uncertainties, including those relating to competing products and technologies,
- commodity price volatility, particularly with respect to the price of natural gas,
- the difficulty of estimating construction, development, repair, maintenance and operating costs and timeframes,
- the uncertainties involved in estimating insurance and warranty recoveries, if any,
- the inability to predict the course or outcome of any negotiations with parties involved with our projects,
- uncertainties relating to general economic and industry conditions,
- uncertainties relating to government and regulatory policies, the legal environment, intellectual property issues and the competitive environment in which Environmental Power Corporation and its subsidiaries operate,

and other factors, including those described in Part II, Item 1A of this Quarterly Report on Form 10-Q under the heading Risk Factors, as well as factors set forth in other filings we make with the Securities and Exchange Commission. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date that they are made. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

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Item 1. Financial Statements

ENVIRONMENTAL POWER CORPORATION AND SUBSIDIARIES

Condensed Consolidated Balance Sheets (unaudited) as of September 30, 2009 and December 31, 2008

	September 30, 2009	December 31, 2008
ASSETS		
Current Assets		
Cash and cash equivalents	**$ 1,080,863**	$ 3,157,938
Restricted cash	**98,463,131**	104,577,246
Receivables	**559,189**	373,039
Other current assets	**110,321**	60,210
Total Current Assets	**100,213,504**	108,168,433
Restricted cash, non current	**503,612**	553,014
Property, plant and equipment, net	**25,408,443**	23,932,073
Construction in progress	**23,510,184**	20,101,314
Licensed technology rights, net	**2,190,171**	2,329,296
Notes receivable, net	**1,540,498**	1,608,500
Deferred financing costs, net	**5,442,486**	5,122,995
Other assets	**446,641**	197,569
TOTAL ASSETS	**$ 159,255,539**	$ 162,013,194
LIABILITIES, PREFERRED STOCK AND SHAREHOLDERS EQUITY		
Current Liabilities		
Accounts payable and accrued expenses	**$ 7,586,502**	$ 4,322,896
Current portion of long-term debt	**62,425,000**	
Total Current Liabilities	**70,011,502**	4,322,896
Other Liabilities	**331,370**	340,706
Long-term debt	**75,027,489**	129,475,023
Total Liabilities	**145,370,361**	134,138,625
Minority Interests	**100**	100
Preferred Stock (1)	**10,156,021**	10,156,021
Shareholders Equity		
Preferred stock (2)	**100**	100
Common stock (3)	**158,030**	157,030
Additional paid-in capital	**86,420,560**	89,986,923
Accumulated deficit	**(81,823,006)**	(71,401,984)
Treasury stock (4)	**(388,408)**	(385,402)
Notes receivable from current directors and former officer and director	**(638,219)**	(638,219)
Total Common Shareholders Equity	**3,728,957**	17,718,348

Total Shareholders Equity	**3,729,057**	17,718,448
TOTAL LIABILITIES, PREFERRED STOCK AND SHAREHOLDERS EQUITY	**$ 159,255,539**	$ 162,013,194

(1) Preferred stock, $.01 par value, 2,000,000 shares authorized; 281,241 shares issued as of September 30, 2009 and December 31, 2008. Stated value at September 30, 2009 and December 31, 2008 of $52.71 per share or $14,824,213.

(2) Preferred stock of subsidiary, no par value, 10 shares authorized; 10 shares issued as of September 30, 2009 and December 31, 2008, respectively.

(3) $.01 par value; 50,000,000 shares authorized; 15,803,034 issued and 15,708,591 outstanding as of September 30, 2009 and 15,703,034 issued and 15,614,604 outstanding as of December 31, 2008.

(4) 94,443 shares at cost as of September 30, 2009 and 88,430 shares at cost as of December 31, 2008.

See Notes to Consolidated Financial Statements.

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ENVIRONMENTAL POWER CORPORATION AND SUBSIDIARIES

Condensed Consolidated Statements of Operations (unaudited) for the Three and Nine Months

Ended September 30, 2009 and September 30, 2008

	Three Months Ended		Nine Months Ended	
	September 30, 2009	September 30, 2008	September 30, 2009	September 30, 2008
REVENUES	**$ 1,358,687**	$ 456,250	**$ 3,272,329**	$ 2,538,941
COSTS AND EXPENSES:				
Operations and maintenance	**708,159**	1,784,707	**2,580,366**	5,037,907
General and administrative	**1,606,795**	2,865,233	**5,184,580**	9,737,772
Depreciation and amortization	**433,109**	378,747	**1,265,642**	993,100
Impairment of assets	**5,885,614**		**5,885,614**	
TOTAL COSTS AND EXPENSES	**8,633,677**	5,028,687	**14,916,202**	15,768,779
OPERATING LOSS	**(7,274,990)**	(4,572,437)	**(11,643,873)**	(13,229,838)
OTHER INCOME (EXPENSE):				
Interest income	**2,493**	87,700	**31,082**	434,454
Interest expense	**(693,034)**	(262,690)	**(1,599,550)**	(704,716)
Other income (expense)	**21,090**	(14,620)	**94,173**	(36,862)
TOTAL OTHER INCOME (EXPENSE)	**(669,451)**	(189,610)	**(1,474,295)**	(307,124)
LOSS BEFORE INCOME TAXES	**(7,944,441)**	(4,762,047)	**(13,118,168)**	(13,536,962)
INCOME TAX EXPENSE	**5,812**		**28,812**	
NET LOSS FROM CONTINUING OPERATIONS	**(7,950,253)**	(4,762,047)	**(13,146,980)**	(13,536,962)
LOSS FROM DISCONTINUED OPERATIONS, NET OF TAXES OF $0				(1,010,534)
GAIN ON DISPOSAL OF DISCONTINUED OPERATIONS, NET OF TAXES OF $0				7,999,858
NET LOSS	**(7,950,253)**	(4,762,047)	**(13,146,980)**	(6,547,638)
Preferred Securities Dividend Requirements	**(333,545)**	(325,634)	**(1,000,633)**	(992,726)
LOSS APPLICABLE TO COMMON SHAREHOLDERS	**$ (8,283,798)**	$ (5,087,681)	**$ (14,147,613)**	$ (7,540,364)
BASIC AND DILUTED INCOME (LOSS) PER SHARE:				
CONTINUING OPERATIONS	**$ (0.53)**	$ (0.33)	**$ (0.91)**	$ (0.93)
DISCONTINUED OPERATIONS				0.45
NET LOSS PER SHARE	**$ (0.53)**	$ (0.33)	**$ (0.91)**	$ (0.48)
SHARES USED TO CALCULATE INCOME (LOSS) PER SHARE BASIC and DILUTED	**15,588,998**	15,579,354	**15,585,819**	15,579,354

See Notes to Consolidated Financial Statements.

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ENVIRONMENTAL POWER CORPORATION AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows (unaudited) for the Nine Months

Ended September 30, 2009 and September 30, 2008

	Nine Months Ended	
	September 30, 2009	**September 30, 2008**
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	**$ (13,146,980)**	$ (6,547,638)
Non-cash adjustments		
Results of discontinued operations		(6,989,324)
Impairment of assets	**5,885,614**	
Depreciation and amortization	**1,265,642**	993,100
Stock based compensation expense	**328,605**	1,682,244
Non-cash income from adjustment to fair value of warrants	**(121,320)**	
Changes in operating assets and liabilities:		
(Increase) decrease in receivables	**(186,150)**	315,351
Decrease in other current assets	**(50,111)**	(22,080)
Decrease in notes receivable	**68,002**	197,613
Increase in accounts payable and accrued expenses	**738,000**	1,949,316
Net cash used in operating activities	**(5,218,698)**	(8,421,418)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Disposal of discontinued operations		375,000
Decrease (increase) in restricted cash	**6,163,517**	(65,320,423)
Construction of projects	**(6,270,732)**	(11,505,420)
Purchase of property, plant and equipment	**(210,760)**	(375,493)
Purchase of treasury stock	**(3,006)**	
(Increase) decrease in other assets	**(249,072)**	26,976
Net cash used in investing activities	**(570,053)**	(76,799,360)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Increase in deferred financing costs	**(543,309)**	(2,511,429)
Payment of preferred dividends	**(667,088)**	(1,334,179)
Increase (decrease) in other liabilities	**(55,393)**	119,224
Payments on long-term debt	**(22,534)**	
Proceeds from issuance of long term debt	**5,000,000**	69,378,924
Payments of dividend on behalf of subsidiary		(15,000)
Net cash provided by financing activities	**3,711,676**	65,637,540
DECREASE IN CASH AND CASH EQUIVALENTS	**(2,077,075)**	(19,583,238)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	**3,157,938**	26,069,198
CASH AND CASH EQUIVALENTS, END OF PERIOD	**$ 1,080,863**	$ 6,485,960
Supplemental disclosure of cash flow information		
Cash paid for interest (net of amount capitalized)	**$ 905,753**	$ 529,716
Income Taxes	**28,812**	
Non-cash investing and financing activity		

Payment of license fees with issuance of 14% convertible note	**3,000,000**	
Accrued dividend requirement of series A preferred stock	**1,000,633**	326,634
Capitalized amortization of deferred financing costs	**114,304**	60,066

See Notes to Consolidated Financial Statements.

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ENVIRONMENTAL POWER CORPORATION AND SUBSIDIARIES

Condensed Consolidated Statement of Equity (unaudited) for Nine Months Ended September 30, 2009

	Common Stock - Shares	Common Stock - Amount	Additional Paid-in Capital	Accum. Deficit	Treasury Stock - Shares	Treasury Stock - Amount	Receivable - Officers & Directors	Total
Balance at December 31, 2008	**15,703,034**	**$ 157,030**	**$ 89,986,923**	**$ (71,401,984)**	**88,430**	**$ (385,402)**	**$ (638,219)**	**$ 17,718,348**
Cumulative effect of change in accounting principle - January 1, 2009 reclassification of equity-linked financial instruments to derivative liabilities			(3,893,968)	3,726,591				(167,377)
Dividends on preferred stock				(1,000,633)				(1,000,633)
Stock based compensation expense			328,605					328,605
Issuance of restricted stock	100,000	1,000	(1,000)					
Treasury Stock					6,013	(3,006)		(3,006)
Net loss				(13,146,980)				(13,146,980)
Balance at September 30, 2009	**15,803,034**	**$ 158,030**	**$ 86,420,560**	**$ (81,823,006)**	**94,443**	**$ (388,408)**	**$ (638,219)**	**$ 3,728,957**

See Notes to Consolidated Financial Statements.

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Notes to Condensed Consolidated Financial Statements

NOTE A BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements of Environmental Power Corporation (we , us , EPC Environmental Power , or the Company) and our subsidiaries have been prepared in accordance with the instructions to Form 10-Q and with Article 10 of Regulation S-X and include all of the information and footnotes required by generally accepted accounting principles for interim financial information. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. The results of operations for the three and nine months ended September 30, 2009 are not necessarily indicative of results to be expected for the year ending December 31, 2009. The information in this quarterly report should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements and footnotes included in our Annual Report on Form 10-K for the year ended December 31, 2008 (Annual Report).

The Annual Report includes important information necessary or useful to understanding the Company s business and financial statement presentation. In particular, the Company s significant accounting policies and procedures are presented as Note C Significant Accounting Policies to the consolidated financial statements included in the Annual Report.

Impairment of Assets

Due to the expected redemption or repurchase of a portion of our Texas and California tax-exempt bonds, as discussed in Note H Long Term Obligations and Contractual Commitments , we are required to record non-cash impairments on our Mission Dairy, Texas project and one of our three California projects. These non-cash impairments are described more fully in Note M Impairment of Assets . It should be noted that the recording of these impairments is required by the applicable accounting rules and does not mean we will not complete these projects at a future date. We still retain valid permits at these sites and other items of value to us, such as relationships with local farms and preliminary designs and plans, which we may utilize when we are able to obtain financings for these projects and proceed with their development.

Codification of Accounting Standards

The Company follows accounting policies and standards set by the Financial Accounting Standards Board, commonly referred to as the (FASB). The FASB sets generally accepted accounting principles (GAAP) that we adhere to so that we can ensure we consistently report our financial condition (balance sheet), results of operations and cash flows. Over the years the FASB and other designated GAAP setting bodies have issued standards in the form of FASB Statements, Interpretations, FASB Staff Positions, EITF consensus, AICPA Statements of Position and other standards.

The FASB recognized the complexity of its standard setting process and embarked on a revised process in 2004 that culminated in the release on July 1, 2009 of the *FASB Accounting Standards Codification,* sometimes referred to as the Codification or ASC. The ASC rearranges how GAAP pronouncements are organized and consolidated all GAAP pronouncements into one document. The impact of this change is that instead of referring to a FASB Statement or Interpretation, we will reference the ASC Topic as appropriate. It is important to note the Codification did not change in any way how the Company accounts for transactions or the nature of related disclosures made. References to GAAP issued by the FASB are to the *FASB Accounting Standards Codification,* referred to as the Codification or ASC.

The change was effective for periods ending on or after September 15, 2009, and so we have updated our references in this current report on Form 10-Q to reflect the appropriate Topic in the ASC. Prior FASB standards such as FASB Statement No. 128 *Earnings Per Share* are no longer referred to using this nomenclature and are no longer being issued by the FASB.

Reclassification

Amounts on the consolidated statements of cash flows for the nine months ended September 30, 2008 have been reclassified to reflect the January 2008 and July 2008 payment of preferred dividends.

NOTE B GOING CONCERN

The Company s consolidated financial statements have been prepared on a going concern basis, which contemplates continuity of operations, realization of assets and satisfaction of liabilities in the ordinary course of business. As a predominately development oriented company, we have experienced substantial losses since the year ended December 31, 2002. For the nine months ended September 30, 2009, we incurred a net loss applicable to common shareholders of $14,148,000, and used cash from operating activities of $5,219,000. For the year ended

December 31, 2008, we incurred a net loss applicable to common shareholders of $17,333,000 and used cash of $13,100,000 in operating activities. We anticipate incurring losses at least through 2010 as we continue the construction of our portfolio of announced projects. As of September 30, 2009, we had an accumulated deficit of $81,823,000 and our unrestricted cash and cash equivalents amounted to $1,081,000. Currently, our facility at Huckabay Ridge, Texas, which is

Notes to Condensed Consolidated Financial Statements (Continued)

operating reliably, is anticipated to generate cash flow over the balance of the year. However, the cash we project to be generated from Huckabay Ridge, by itself, will be insufficient to meet our short-term and long-term corporate and project-related capital requirements.

In the past, we have been able to obtain outside financing to fund our losses and meet our capital requirements with the anticipation that once our projects are complete and operational, they would contribute to future liquidity needs. While we have substantially reduced our general and administrative expense, and Huckabay Ridge is generating positive cash flow, we will need additional funds to meet all of the required interest payments on debt and preferred dividend payment due December 1, 2009 and January 1, 2010. In addition, our cash forecasts indicate we will only be able to maintain corporate headquarters operations for a limited period. We are currently actively seeking additional funds from a variety of sources but there can be no guarantee we will raise sufficient funds to meet these obligations.

We have been working with Marathon Capital, LLC to obtain final financing proposals from prospective investors in support of its announced project pipeline. As a result of these activities, Environmental Power and our subsidiary, Microgy Holdings, LLC (Microgy Holdings), have entered into a non-binding letter of intent with a potential investor relating to, among other things, the purchase of newly issued equity interests in Microgy Holdings, the proceeds of which would be used for the completion of certain projects currently under development and construction by Microgy Holdings and its subsidiaries, as well as reimbursement of certain intercompany receivables owed by Microgy Holdings to Environmental Power. The letter of intent also addresses the development and funding of future projects based on the technology of Microgy, Inc. (Microgy). The letter of intent is not binding, and the transactions contemplated thereby remain subject to investor due-diligence and the negotiation, execution and delivery of definitive agreements.

We cannot assure you that any such definitive agreements will be entered into or that the transactions contemplated by the letter of intent will be executed. The potential investor has the right to terminate the non-binding letter of intent at any time for any reason. In addition, Environmental Power will need to continue to seek interim financing to fund operations while it seeks to finalize and close the transactions contemplated by the letter of intent. The level of funds we are able to raise, if any, will determine the level of development and construction activity that we can pursue and whether we will be able to continue as a going concern.

The accompanying consolidated financial statements have been prepared assuming that we will continue as a going concern. The uncertainties described above raise substantial doubt at September 30, 2009 about our ability to continue as a going concern without additional financing. The accompanying consolidated financial statements do not include any adjustments relating to the recoverability and classification of the carrying amount of recorded assets or to the amount and classification of liabilities that might result should we be unable to continue as a going concern.

NOTE C THE COMPANY

We are a developer, owner, and operator of renewable energy production facilities. Our goal is to produce Energy that is Beyond Renewable®, which we define as energy that not only uses waste materials instead of limited resources, but that also is clean, reliable, and cost-effective. We own and operate the Huckabay Ridge facility in Stephenville, Texas, a large-scale, multi-digester facility for the production of pipeline-grade natural gas which began commercial operation in the first quarter of 2008, and have several similar facilities in varying stages of development. We also operate three digester facilities in Wisconsin utilizing the same technology that is employed at Huckabay Ridge.

In the past, we have operated in two major segments through Microgy, Inc., (Microgy) as a developer of renewable energy facilities for the production and commercial application of methane-rich biogas from agricultural and food industry wastes, and through EPC Corporation and its subsidiary Buzzard Power Corporation (Buzzard), as holder of a leasehold interest in a waste-coal fired generating facility in Pennsylvania known as the Scrubgrass facility. On May 31, 2007, our board of directors authorized management to enter into negotiations regarding the disposition of the leasehold interest in the Scrubgrass facility. On February 29, 2008, we reported the disposition of the leasehold interest. As a result, for financial reporting purposes, the results of Buzzard are reported as discontinued operations in the accompanying condensed consolidated financial statements. We thus now operate only in Microgy s segment.

Microgy Holdings, LLC was formed in 2006 as a subsidiary of Environmental Power Corporation in connection with the $60 million tax-exempt debt financing we completed in November 2006 relating to the construction and operation of four RNG® facilities in Texas. The assets financed by the debt financing are pledged as collateral to the Gulf Coast Industrial Development Authority of Texas, the lender. The obligations of Microgy Holdings, LLC related to this financing are non recourse to Environmental Power, although Environmental Power is required to provide at least 20% of the construction costs of these facilities, as well as to cover any cost overruns in construction and start up and commissioning expenses prior to commercial operation. Microgy Holdings, LLC is also the obligor on what was initially $62.425 million in tax-exempt debt financing from the California Statewide Communities Development Authority which we completed in September 2008 on terms similar to those of the Texas financing. Redemption and

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Notes to Condensed Consolidated Financial Statements (Continued)

repayment of a portion of these bonds and terms on the remaining Texas and California bonds are discussed in Note H to the condensed consolidated financial statements. We expect as a result of the proposed redemption and purchase of Texas and California bonds described in Note H below, the outstanding principal amounts of the Texas and California bonds will be reduced to $45,000,000 and $32,212,500, respectively, on or about November 15, 2009.

Microgy Grand Island, LLC is the obligor on $7.0 million in tax-exempt debt financing from the City of Grand Island, Nebraska, relating to the construction of our facility at the flagship beef processing plant of JBS Swift & Company, located in Grand Island, Nebraska. The obligations of Microgy Grand Island, LLC related to this financing are non-recourse to Environmental Power, although Environmental Power is required to provide at least 20% of the construction costs of these facilities, as well as to cover any cost overruns in construction and start up and commissioning expenses prior to commercial operation. In certain cases of redemption of the Nebraska bonds, Environmental Power may also be liable for financing costs paid from bond proceeds. .

Discontinued Operations

In May 2007, our board of directors authorized management to pursue negotiations for the disposition of Buzzard Power Corporation s leasehold interest in the Scrubgrass facility, referred to as Scrubgrass. Buzzard is a subsidiary of our wholly owned subsidiary, EPC Corporation. Scrubgrass located on a 600-acre site in Venango County, Pennsylvania, is an approximate 83 megawatt waste coal-fired electric generating station. We decided to seek the disposition of Buzzard s leasehold interest in the Scrubgrass facility to allow management to focus its attention and resources on the development and growth of Microgy. On February 29, 2008 we completed all transactions necessary to terminate the leasehold interest held by Buzzard in the Scrubgrass generating facility and the related financial obligations of Buzzard s immediate parent company, EPC Corporation. We recorded net income from discontinued operations in 2008 of $6,989,000 reflecting a loss from operations for the months of January and February 2008 of $1,011,000 and a one-time gain from disposal of $8,000,000. The gain of approximately $8,000,000, with the exception of a cash payment of $375,000, was non-cash in nature. The components of the gain included $3,456,000 in forgiveness of indebtedness, $2,570,000 for the recognition of a previously deferred gain and $1,630,000 for the relief of net obligations of Buzzard. The disposition was recorded net of a tax obligation of $0 because it is anticipated that existing net operating loss carryforwards will offset any federal or state tax liabilities.

The assets and liabilities of Buzzard have been accounted for as discontinued operations for all periods presented. We do not have a continuing involvement with the Buzzard business since the closing of the disposition of the leasehold interest in the Scrubgrass facility and do not continue any revenue or cost-generating activities related to Buzzard. The accompanying consolidated balance sheets report the assets and liabilities of Buzzard as discontinued and the consolidated statements of operations report the operations of Buzzard as discontinued operations.

NOTE D PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment is stated at cost less accumulated depreciation. The cost of maintenance, repairs and minor renewals that do not materially prolong the useful life of the asset are expensed. Major maintenance projects, repairs, improvements, renewals or betterments that extend the useful life of the asset, increase the usefulness or output of the asset, lower the operating costs of the asset, increase the value of the asset or fulfill a new or upgraded regulatory requirement are capitalized. The cost and accumulated depreciation for property, plant and equipment disposals are removed from the balance sheet and any resulting gains or losses are reported in the statement of operations at the time of the asset disposition. We depreciate property plant and equipment using the straight-line method over the estimated useful lives of the assets. Operating commercial facilities are depreciated based on the useful lives of their component parts which vary in length from 15 to 30 years. We record depreciation for office equipment and furniture using the straight-line method over periods from three to five years and we depreciate leasehold improvements over the lesser of the useful life of the asset or the length of the lease. We evaluate the need for impairment of property, plant and equipment based on the projection of undiscounted cash flows whenever events or changes in circumstances indicate that the carrying amounts of such assets may not be recoverable. If such cash flows are not expected to be sufficient to recover the recorded value of the assets, the assets are written down to their estimated fair values. See Note M Impairment of Assets .

NOTE E GOODWILL AND INTANGIBLE ASSETS

Intangible assets are recorded at cost and consist of licensed technology rights. Licensed technology rights are being amortized using the straight-line method over a useful life of 20 years.

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Notes to Condensed Consolidated Financial Statements (Continued)

Accumulated amortization of licensed technology rights was $1,519,829 as of September 30, 2009 and $1,380,704 as of December 31, 2008. Amortization expense for licensed technology rights was $139,125 for the nine months ended September 30, 2009 and September 30, 2008. The future estimated amortization expense for licensed technology rights is as follows:

Estimated Amortization Expense for Licensed Technology Rights

Remaining 2009	2010	2011	2012	2013	Thereafter	Total
$ 46,375	185,500	185,500	185,500	185,500	1,401,796	$ 2,190,171

In 2008, we determined that our goodwill resulting from the acquisition of Microgy was impaired and the entire balance of $4,913,000 was written off in the fourth quarter of 2008. This impairment was a non-cash, non-recurring charge. We annually perform tests to determine the appropriate value of goodwill. The results of these tests in 2008 resulted in our determination that the entire balance of $4,913,000 was impaired, due primarily to the stock price of our common stock relative to its book value, projections of future cash flow and other factors. Previously, the market price of our common stock and consequently our market capitalization were relatively high compared to the book value of our common stock. However in 2008 our market value was substantially below our book value due principally to the current market price of our common stock. As a result accounting standards require us to determine whether there is enough market value after covering other net assets on a book basis to cover any of the goodwill. We determined that market value was insufficient to cover goodwill and determined that the write-off was required. This calculation is not a reflection of the economics of the projects we are undertaking, which we continue to stand behind, but is simply the application of accounting requirements associated with goodwill.

NOTE F DEFERRED FINANCING COSTS

Deferred financing costs include costs directly attributable to our issuance of debt securities. In accordance with ASC 340-10 Other Assets and Deferred Costs , these costs are deferred and capitalized as part of deferred financing costs. These costs are amortized over the remaining life of the related debt.

NOTE G NOTES RECEIVABLE INCLUDING CURRENT DIRECTORS AND FORMER OFFICER AND DIRECTOR

Notes Receivable In 2005, we completed construction of the digester projects at Five Star Dairy, Wild Rose Dairy, and Norswiss Dairy. Each digester had a purchase price of $1,037,000, of which Microgy agreed to provide 100% seller financing. The notes issued by the purchasers of the digester projects each bear simple interest at 5% per annum, to be paid monthly after the first month that revenues are received under the purchasers respective biogas supply agreement with Dairyland Power Cooperative. Each maker of these notes is only required to make interest and principal payments from the revenues under the applicable biogas supply agreement with Dairyland Power Cooperative, to the extent that the operation of the facility, which we manage and operate, provides sufficient funds to pay. Each note matures 11 years after the bill of sale for the facility to which it relates has been executed. Because we have limited operating history, we have set up a reserve on these notes in the amount of $750,000 to allow for any future cash flow deficiencies that would impair the full value of the notes. We also do not expect to record interest income from these notes. As we gain operations and maintenance experience and develop a track record, we will evaluate this allowance and make adjustments accordingly. The following table shows the balance on these notes receivable on September 30, 2009 and December 31, 2008:

	September 30, 2009	December 31, 2008
Notes Receivable		
Notes receivable	$ 2,290,498	$ 2,358,500
Reserve for any future cash flow deficiencies	(750,000)	(750,000)
Notes receivable, net	**$ 1,540,498**	**$ 1,608,500**

Beginning in the third quarter of 2007, we sold the greenhouse gas sequestration credits generated from the Wisconsin facilities. Pursuant to our agreements with the owners of these facilities, 50% of these sales were recognized by us as revenue and 50% was applied to the balance of the notes. During the first nine months of 2009 and 2008, the balance of the notes receivable was reduced by $18,000 and $198,000, respectively due to the sale of greenhouse gas sequestration credits. The sales for the nine months ended September 30, 2008 included revenues for credits generated by vintage years 2005 to 2007 but the sales for the nine months ended September 30, 2009 includes credits generated only during the first six months of 2008. Under the terms of the notes the balance of the notes is also reduced by cumulative profits of the Wisconsin facilities from gas sales. In the first nine months of 2009, note receivable balance and revenues were reduced by $50,000 from the cumulative profits at these facilities.

Notes Receivable from Officers and Directors We have outstanding notes receivable from former and current officers and directors for shares purchased in connection with stock option plans that amounted to $638,219 as of September 30, 2009 and December 31, 2008. These notes, partially secured by the underlying shares of stock purchased thereby, are payable upon demand and bear interest at a floating rate which is payable monthly. In accordance with company policy and applicable law, we no longer make loans to our officers or directors.

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Notes to Condensed Consolidated Financial Statements (Continued)

NOTE H LONG-TERM OBLIGATIONS AND CONTRACTUAL OBLIGATIONS

Issuance of Long-Term Debt

On March 13, 2009, we closed on the sale of $5,000,000 original principal amount of our 14% convertible notes due January 1, 2014, referred to as the notes, for net proceeds of approximately $4,464,000. The notes are unsecured obligations of Environmental Power Corporation and pay interest semi-annually on January 1 and July 1, with principal due at maturity. The notes are convertible into shares of our common stock of the Company beginning at an initial conversion price of $5.40 a share through December 31, 2009, then increasing to $6.33 per share from January 1, 2010 through December 31, 2010, $7.65 per share from January 1, 2011 through December 31, 2011, $9.75 per share from January 1, 2012 through December 31, 2012 and $11.00 per share from January 1, 2013 to December 31, 2013.

On May 22, 2009 we issued an additional $3,000,000 of these notes as payment for upfront license fees related to certain of our projects under a Cooperation Agreement entered into in April 2009 with the licensor of Microgy s technology as described in more detail below.

The terms of the notes are governed by an Indenture, dated as of March 1, 2009, as supplemented by a First Supplemental Trust Indenture, dated as of March 1, 2009, as amended and supplemented to date, between us and Wells Fargo Bank, National Association, as Trustee, collectively referred to as the indenture. The indenture contains covenants which include restrictions and limitations on our ability and that of our subsidiaries to incur indebtedness and issue certain types of capital stock and engage in certain transactions. In certain instances described in the indenture, the holders of the notes can require us to repurchase or redeem the notes, and we can require holders of the notes to convert into common stock or redeem their notes. The proceeds of these notes can only be used for the costs and expenses associated with the construction and operation of our projects, as described in more detail in the indenture. The First Supplemental Indenture provides for the issuance of notes in an aggregate original principal amount of up to $53,000,000.

Contractual Obligations

The following table shows our known significant future contractual obligations as of September 30, 2009 of the types specified in Item 303(a)(5) of Regulation S-K. The table includes both the principal and interest payments on the tax-exempt bonds and convertible notes over the projected minimum life of the related debt.

Commitments	**2009**	**2010**	**2011**	**2012**	**2013**	**Thereafter**	**Total**
Operating Leases(1)	$ 84,168	$ 336,672	$ 298,500	$ 111,078			$ 830,418
Microgy Commitments(2)	3,000,000						3,000,000
14% convertible notes(3)		1,120,000	1,120,000	1,120,000	1,120,000	$ 8,000,000	12,480,000
Tax-Exempt Bonds(4)	67,345,031	4,690,000	5,040,000	5,955,500	6,054,600	126,784,800	215,869,931
Security Deposit(5)		100,000	100,000	100,000	100,000		400,000
Vehicle Loans (6)	6,770	19,814	1,476				28,060
TOTAL	$ 70,435,969	$ 6,266,486	$ 6,559,976	$ 7,286,578	$ 7,274,600	$ 134,784,800	$ 232,608,409

(1) We are obligated under various non-cancelable operating leases for office space. These obligations have not been reduced by estimated total proceeds from the sublease of our Golden Colorado facility of $167,500. Rent expense for these operating leases was $371,637, $424,765, and $286,501 in 2008, 2007 and 2006, respectively. For the three and nine months ended September 30, 2009, our rent expense for operating leases was $54,335 and $211,335, respectively.

(2) These commitments relate to various purchase agreements, and include amounts expected to be claimed by SouthTex Treaters for gas treatment and conditioning equipment, in connection with our Microgy facilities.

(3) The entire balance of the 14% convertible notes is due January 1, 2014.

(4) In 2007, Microgy Holdings began scheduled interest payments on the tax-exempt bonds. In 2008 Microgy Grand Island began scheduled interest payments on the tax-exempt bonds. Mandatory redemption of principal amounts begins in 2011 for the Nebraska tax-exempt bonds and 2012 for the Texas tax-exempt bonds. See below California and Texas Bonds for a discussion of the anticipated repurchase or redemption of a portion of the California and Texas bonds. This schedule has been completed based on status of the bonds at

September 30, 2009 and does not reflect the impact of expected redemption or repurchase of a portion of the bonds.

(5) In December 2008, Microgy signed a contract with a customer that required security deposits to protect against failure to deliver product in certain instances.

(6) We are obligated under various loans for automobiles.

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Notes to Condensed Consolidated Financial Statements (Continued)

The following table describes our long-term debt obligations as of September 30, 2009 and December 31, 2008:

Secured Promissory Notes Payable and Other Obligations	September 30, 2009	December 31, 2008
Automobile loans & capital leases	$ 27,489	$ 50,023
14% convertible notes	8,000,000	
California loan related to tax-exempt bonds		62,425,000
Nebraska loan related to tax-exempt bonds		