
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 **March 31, 2015**

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 office)

43035

(Zip Code)

(614) 505-6115

(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

Accelerated filer

Non-accelerated filer

Smaller reporting company

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; 41,036,132 outstanding as of May 15, 2015.

MIDWEST ENERGY EMISSIONS CORP.

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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 2014 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, 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, failure to obtain adequate working capital to execute the business plan 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.

ITEM 1 – FINANCIAL INFORMATION

MIDWEST ENERGY EMISSIONS CORP. AND SUBSIDIARIES

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Period Ended March 31, 2015

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MIDWEST ENERGY EMISSIONS CORP. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
MARCH 31, 2015 AND DECEMBER 31, 2014
(UNAUDITED)

| | March 31, 2015 | December 31, 2014 |
|--|---------------------------|----------------------------------|
| | (Unaudited) | |
| ASSETS | | |
| Current assets | | |
| Cash and cash equivalents | \$ 2,013,957 | \$ 7,212,114 |
| Accounts receivable | 1,238,344 | 410,950 |
| Inventory | 7,076,358 | 5,784,905 |
| Prepaid expenses and other assets | 156,441 | 140,559 |
| Total current assets | 10,485,100 | 13,548,528 |
| Property and equipment, net | 753,047 | 255,330 |
| License, net | 63,236 | 64,707 |
| Prepaid expenses and other assets | 11,364 | 13,799 |
| Debt issuance costs, net | 2,116,032 | 2,285,696 |
| Customer acquisition costs, net | 1,107,404 | 1,156,521 |
| Total assets | \$ 14,536,183 | \$ 17,324,581 |
| LIABILITIES AND STOCKHOLDERS' DEFICIT | | |
| Current liabilities | | |
| Accounts payable and accrued expenses | \$ 1,064,834 | \$ 688,730 |
| Accrued legal and consulting fees | 92,785 | 86,304 |
| Accrued salaries and benefits | 402,570 | 399,487 |
| Deferred revenue | 7,195,251 | 5,808,301 |
| Convertible notes payable | 3,408,150 | 3,080,376 |
| Customer credits | 936,500 | 936,500 |
| Other current liabilities | - | 250,000 |
| Total current liabilities | 13,100,090 | 11,249,698 |
| Convertible notes payable, net of discount | 4,672,782 | 4,724,598 |
| Warrant liability | 7,475,561 | 5,597,011 |
| Accrued interest | 167,790 | 337,999 |
| Total liabilities | 25,416,223 | 21,909,306 |
| Stockholders' deficit | | |
| Preferred stock, \$.001 par value; 2,000,000 shares authorized | - | - |
| Common stock; \$.001 par value; 150,000,000 shares authorized; | | |
| 40,451,388 shares issued and outstanding as of March 31, 2015 | | |
| 40,228,123 shares issued and outstanding as of December 31, 2014 | 40,451 | 40,228 |
| Additional paid-in capital | 19,385,718 | 19,113,724 |
| Accumulated deficit | (30,306,209) | (23,738,677) |
| Total stockholders' deficit | (10,880,040) | (4,584,725) |
| Total liabilities and stockholders' deficit | \$ 14,536,183 | \$ 17,324,581 |

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

MIDWEST ENERGY EMISSIONS CORP. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE MONTHS ENDED MARCH 31, 2015 AND 2014
(UNAUDITED)

| | For the Three Months Ended March 31, 2015 | For the Three Months Ended March 31, 2014 |
|---|--|--|
| | <u>(Unaudited)</u> | <u>(Unaudited)</u> |
| Revenues | \$ 243,344 | \$ - |
| Costs and expenses: | | |
| Cost of goods sold | 149,689 | - |
| Operating expenses | 347,170 | 20,287 |
| License maintenance fees | 75,000 | 75,000 |
| Selling, general and administrative expenses | 556,255 | 543,736 |
| Depreciation and amortization | 65,588 | 43,507 |
| Professional fees | 170,245 | 232,852 |
| Stock based compensation | <u>125,528</u> | <u>2,188,675</u> |
| Total costs and expenses | <u>1,489,475</u> | <u>3,104,057</u> |
| Operating loss | (1,246,131) | (3,104,057) |
| Other expenses | | |
| Interest expense | (3,422,356) | (298,209) |
| Change in value of warrant liability | (1,878,550) | - |
| State income taxes | <u>(20,495)</u> | <u>-</u> |
| Total other expenses | <u>(5,321,401)</u> | <u>(298,209)</u> |
| Net loss | <u>\$ (6,567,532)</u> | <u>\$ (3,402,266)</u> |
| Net loss per common share - basic and diluted: | <u>\$ (0.16)</u> | <u>\$ (0.09)</u> |
| Weighted average common shares outstanding | <u>40,414,884</u> | <u>37,318,502</u> |

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

MIDWEST ENERGY EMISSIONS CORP. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIT
FOR THE THREE MONTHS ENDED MARCH 31, 2015
(UNAUDITED)

| | <u>Common Stock</u> | | <u>Additional Paid-in Capital</u> | <u>Accumulated (Deficit)</u> | <u>Total Stockholders' Deficit</u> |
|--|---------------------|------------------|---|----------------------------------|--|
| | <u>Shares</u> | <u>Par Value</u> | | | |
| Balance - December 31, 2014 | 40,228,123 | \$ 40,228 | \$19,113,724 | \$ (23,738,677) | \$ (4,584,725) |
| Stock issued for interest on notes payable | 170,500 | 171 | 103,834 | - | 104,005 |
| Stock and warrants issued upon debt conversion | 52,765 | 52 | 42,632 | - | 42,684 |
| Issuance of stock options | - | - | 125,528 | - | 125,528 |
| Net loss for the period | | | | (6,567,532) | (6,567,532) |
| Balance - March 31, 2015 | <u>40,451,388</u> | <u>\$ 40,451</u> | <u>\$19,385,718</u> | <u>\$ (30,306,209)</u> | <u>\$ (10,880,040)</u> |

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

MIDWEST ENERGY EMISSIONS CORP. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE THREE MONTHS ENDED MARCH 31, 2015 AND 2014
(UNAUDITED)

| | For the Three Months Ended March 31, 2015 | For the Three Months Ended March 31, 2014 |
|--|--|--|
| | <u>(Unaudited)</u> | <u>(Unaudited)</u> |
| Cash flows from operating activities | | |
| Net loss | \$ (6,567,532) | \$ (3,402,266) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Stock based compensation | 125,528 | 2,188,675 |
| Stock issued for services | - | 52,500 |
| Amortization of license fees | 1,471 | 1,471 |
| Amortization of discount of notes payable | 2,782,346 | 69,088 |
| Amortization of debt issuance costs | 169,664 | 65,021 |
| Amortization of customer acquisition costs | 49,117 | - |
| Depreciation expense | 15,000 | 42,036 |
| Loss on the change in value of warrant liability | 1,878,550 | - |
| PIK interest | 535,690 | 220,967 |
| Change in assets and liabilities | | |
| Increase in accounts receivable | (827,394) | (479,541) |
| Decrease (increase) in inventory | (1,291,453) | (940,817) |
| Decrease (increase) in prepaid expenses and other assets | (13,447) | 5,040 |
| Increase (decrease) in accounts payable and accrued liabilities | (179,930) | 857,073 |
| Decrease in other current liabilities | 250,000 | - |
| Increase in deferred revenue | 1,386,950 | 1,075,200 |
| Net cash used in operating activities | <u>(1,685,440)</u> | <u>(245,553)</u> |
| Cash flows used in investing activities | | |
| Purchase of property and equipment | (512,717) | - |
| Net cash used in investing activities | <u>(512,717)</u> | <u>-</u> |
| Cash flows from financing activities | | |
| Payment of convertible promissory notes | (3,000,000) | - |
| Proceeds from the issuance of common stock upon warrant exercise | - | 7,813 |
| Net cash (used in) provided by financing activities | <u>(3,000,000)</u> | <u>7,813</u> |
| Net decrease in cash and cash equivalents | (5,198,157) | (237,740) |
| Cash and cash equivalents - beginning of period | 7,212,114 | 509,605 |
| Cash and cash equivalents - end of period | <u>\$ 2,013,957</u> | <u>\$ 271,865</u> |
| SUPPLEMENTAL CASH FLOW INFORMATION: | | |
| Cash paid during the period for: | | |
| Interest | \$ 256 | \$ 3,750 |
| SUPPLEMENTAL DISCLOSURE OF NON-CASH TRANSACTIONS | | |
| Equipment purchases included in accounts payable | \$ 108,133 | \$ 112,000 |
| Accrued sales credits included in customer acquisition costs | \$ - | \$ 970,500 |
| Conversion of debt and accrued interest to equity | \$ 42,684 | \$ 167,057 |
| Issuance of common stock as payment of interest on convertible notes payable | \$ 104,005 | \$ 52,910 |
| Conversion of accrued interest to debt | \$ 535,690 | \$ 220,967 |

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

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 \$0.001 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, 2014.

In management's opinion, the unaudited condensed consolidated financial statements reflect all adjustments (including reclassifications and normal recurring adjustments) necessary to present fairly the financial position as of March 31, 2015, 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.

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. Cash equivalents also include restricted cash of \$12,500 and \$12,500 as of March 31, 2015 and December 31, 2014, respectively.

In addition, per the financing agreement entered into with AC Midwest LLC (the “Lender”) (see Note 8), 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 March 31, 2015 and December 31, 2014, 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.

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. The Company evaluated the recoverability of the carrying value of the Company’s equipment at the site of its commercial customer. No impairment charges were recognized for the quarters ended March 31, 2015 and 2014, respectively.

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.
- *Level 2* — Unadjusted quoted prices in active markets for similar assets or liabilities, or unadjusted quoted prices for identical or similar assets or liabilities in markets that are not active, or inputs other than quoted prices that are observable for the asset or liability.
- *Level 3* — Unobservable inputs that cannot be corroborated by observable market data and reflect the use of significant management judgment. These values are generally determined using pricing models for which the assumptions utilize management’s estimates of market participant assumptions.

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 March 31, 2015 and December 31, 2014 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 March 31, 2015 and December 31, 2014.

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 March 31, 2015 and December 31, 2014 due to their short-term maturities. The fair value of the convertible promissory notes payable at March 31, 2015 and December 2014 approximated the carrying amount as the notes were issued during the three years ended December 31, 2014 at interest rates prevailing in the market and interest rates have not significantly changed as of March 31, 2015. 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.

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, 2014 | \$ - |
| Issuance of warrants | 9,801,200 |
| Change in value of warrant liability | <u>(4,204,189)</u> |
| Balance at December 31, 2014 | <u>\$ 5,597,011</u> |
| Change in value of warrant liability | 1,878,550 |
| Balance at March 31, 2015 | <u>\$ 7,475,561</u> |

Foreign Currency Transactions

The Company's functional currency is the United States Dollar (the "U.S. Dollar"). Transactions denominated in currencies other than the U.S. Dollar are re-measured to the U.S. Dollar at the period-end exchange rates. Any associated transactional currency re-measurement gains and losses are recognized in current operations.

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.

The Company recorded customer acquisition costs totaling \$1,287,500 during the year ended December 31, 2014. The Company entered into agreements with three new customers during this period. The capitalized balance of customer acquisition costs was \$1,107,404 and \$1,156,521 on March 31, 2015 and December 31, 2014, respectively. Amortization expense for the quarters ended March 31, 2015 and 2014 was \$49,117 and zero, respectively.

In accordance with the terms of its customer agreements, the Company made progress billings to four customers a total of \$7,195,251 and \$5,808,301 as of March 31, 2015 and December 31, 2014, respectively, which relate to the future fabrication, delivery and installation of new equipment. This amount is included as deferred revenue at March 31, 2015 and December 31, 2014 and is expected to be recognized as revenue during the year ended 2015 when the equipment is commissioned for use by the customers.

The Company generated revenues of \$243,344 and zero for the quarters ended March 31, 2015 and 2014, respectively. The Company generated revenue for the quarter ended March 31, 2015 by delivering product to its commercial customers.

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 March 31, 2015 and December 31, 2014. 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 2011 or state tax examinations for years prior to 2010.

Basic and Diluted Loss per Common Share

Basic net loss per common share is computed using the weighted average number of common shares outstanding. Diluted 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 March 31, 2015 and 2014, because the Company incurred net losses and basic and diluted losses per common share are the same.

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 March 31, 2015 is on deposit in a non-interest-bearing transaction account that is subject to FDIC deposit insurance limits. For the quarter ended March 31, 2015, 100% of the Company's revenue related to two customers. At March 31, 2015 and December 31, 2014, 100% of the Company's accounts receivable related to four and one 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.

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.

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 1: Identify the contract(s) with a customer.

Step 2: Identify the performance obligations in the contract.

Step 3: Determine the transaction price.

Step 4: Allocate the transaction price to the performance obligations in the contract.

Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation.

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.

In June, 2014, the FASB issued Accounting Standards Update No. 2014-12, Compensation -Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period. The amendments in the ASU require that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. A reporting entity should apply existing guidance in Topic 718, Compensation - Stock Compensation, as it relates to awards with performance conditions that affect vesting to account for such awards. The performance target should not be reflected in estimating the grant-date fair value of the award. Compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the period(s) for which the requisite service has already been rendered. If the performance target becomes probable of being achieved before the end of the requisite service period, the remaining unrecognized compensation cost should be recognized prospectively over the remaining requisite service period. The total amount of compensation cost recognized during and after the requisite service period should reflect the number of awards that are expected to vest and should be adjusted to reflect those awards that ultimately vest. The requisite service period ends when the employee can cease rendering service and still be eligible to vest in the award if the performance target is achieved. The amendments in this ASU are effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. Earlier adoption is permitted. Entities may apply the amendments in this ASU either: (a) prospectively to all awards granted or modified after the effective date; or (b) retrospectively to all awards with performance targets that are outstanding as of the beginning of the earliest annual period presented in the financial statements and to all new or modified awards thereafter. If retrospective transition is adopted, the cumulative effect of applying this ASU as of the beginning of the earliest annual period presented in the financial statements should be recognized as an adjustment to the opening retained earnings balance at that date. In addition, if retrospective transition is adopted, an entity may use hindsight in measuring and recognizing the compensation cost. We are currently assessing the impact this standard will have on the Company's consolidated financial statements and required disclosures.

In June 2014, the FASB issued “Development Stage Entities - Elimination of Certain Financial Reporting Requirements, Including an Amendment to Variable Interest Entities Guidance in Topic 810, Consolidation” (“ASU 2014-10”). ASU 2014-10 eliminates the concept of a development stage entity, thereby eliminating the financial reporting distinction between development stage entities and other reporting entities. As a result of the elimination, certain financial reporting disclosures have been eliminated as well, including the presentation of inception-to-date information and the labeling of financial statements as those of a development stage entity. ASU 2014-10 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2014. The Company elected to early adopt this standard as permitted. Accordingly, beginning with the year ended December 31, 2014, the Company no longer presents inception-to-date information in its consolidated statements of operations, cash flows, and stockholders’ equity.

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 November, 2014, the FASB issued Accounting Standards Update (ASU) No. 2014-16, *Derivatives and Hedging (Topic 815): Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share Is More Akin to Debt or to Equity*. The amendments in this ASU do not change the current criteria in U.S. GAAP for determining when separation of certain embedded derivative features in a hybrid financial instrument is required. The amendments clarify how current U.S. GAAP should be interpreted in evaluating the economic characteristics and risks of a host contract in a hybrid financial instrument that is issued in the form of a share. Specifically, the amendments clarify that an entity should consider all relevant terms and features, including the embedded derivative feature being evaluated for bifurcation, in evaluating the nature of the host contract. Furthermore, the amendments clarify that no single term or feature would necessarily determine the economic characteristics and risks of the host contract. Rather, the nature of the host contract depends upon the economic characteristics and risks of the entire hybrid financial instrument. The amendments in this ASU also clarify that, in evaluating the nature of a host contract, an entity should assess the substance of the relevant terms and features (i.e., the relative strength of the debt-like or equity-like terms and features given the facts and circumstances) when considering how to weight those terms and features. Specifically, the assessment of the substance of the relevant terms and features should incorporate a consideration of: (1) the characteristics of the terms and features themselves (for example, contingent versus non-contingent, in-the-money versus out-of-the-money); (2) the circumstances under which the hybrid financial instrument was issued or acquired (e.g., issuer-specific characteristics, such as whether the issuer is thinly capitalized or profitable and well-capitalized); and (3) the potential outcomes of the hybrid financial instrument (e.g., the instrument may be settled by the issuer issuing a fixed number of shares, the instrument may be settled by the issuer transferring a specified amount of cash, or the instrument may remain legal-form equity), as well as the likelihood of those potential outcomes. The amendments in this ASU apply to all entities that are issuers of, or investors in, hybrid financial instruments that are issued in the form of a share. The amendments in this ASU are effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. For all other entities, the amendments in this ASU are effective for fiscal years beginning after December 15, 2015, and interim periods within fiscal years beginning after December 15, 2016. Early adoption, including adoption in an interim period, is permitted. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. The effects of initially adopting the amendments in this ASU should be applied on a modified retrospective basis to existing hybrid financial instruments issued in the form of a share as of the beginning of the fiscal year for which the amendments are effective. Retrospective application is permitted to all relevant prior periods. 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. For all other entities, the amendments are effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within fiscal years beginning after December 15, 2016. Early adoption of the amendments is permitted for financial statements that have not been previously issued. 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 are currently assessing the impact this standard will have on the Company's consolidated financial statements and required disclosures.

Reclassification

Certain amounts in the prior year have been reclassified to conform to the current presentation.

Note 3 - Going Concern

The accompanying consolidated financial statements as of March 31, 2015 have been prepared assuming the Company will continue as a going concern. The Company has experienced a net loss, negative cash flows from operations and has an accumulated deficit of \$30,306,209. Late in 2014, our customers received one-year extensions on seven of our contracted units to their MATS compliance date which we previously expected to be in compliance in 2015. On March 16, 2015, pursuant to an amendment of the Financing Agreement with AC Midwest Energy, LLC, the Company repaid \$3,000,000 of outstanding convertible note principal (see Note 8). These factors raise substantial doubt about the Company's ability to continue as a going concern. Although we anticipate significant revenues for the sale of capital equipment and products to be used in testing and commissioning work done by clients, no assurances can be given that the Company can obtain sufficient working capital through financing 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. Convertible notes with current principal balances of approximately \$3,200,000 and \$900,000 mature in 2015 and 2016, respectively. Therefore, success in our fund raising efforts and negotiations with our note holders is crucial. We are actively seeking 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. As of May 15, 2015, convertibles notes with principal balances totaling approximately \$1,865,000 were extended through executed amendment agreements with the current convertible note holders. The Company is in the process of seeking such amendments from the remaining note holders, approximately \$400,000 of which have reached maturity, but there can be no assurance that all remaining holders will accept the offered extension terms. The notes of any holders who do not accept will be governed by the original terms thereof.

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, 2014, the Company began the production of equipment to be sold its customers. As of March 31, 2015 and December 31, 2014, costs totaling \$6,898,828 and \$5,714,905, 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 \$177,530 and \$70,000 as of March 31, 2015 and December 31, 2014, respectively.

Note 5 - Property and Equipment, Net

Property and equipment at March 31, 2015 and December 31, 2014 are as follows:

| | March 31, 2015 | December 31, 2014 |
|---------------------------------|---------------------------|----------------------------------|
| Equipment & Installation | \$ 897,496 | \$ 787,918 |
| Trucking equipment | 530,073 | 168,504 |
| Mixing Equipment | 54,490 | 17,103 |
| Office equipment | 23,941 | 23,941 |
| Computer equipment and software | 93,081 | 88,898 |
| Total Equipment | <u>1,599,081</u> | <u>1,086,364</u> |
| Less: accumulated depreciation | <u>846,034</u> | <u>831,034</u> |
| Property and equipment, net | <u>\$ 753,047</u> | <u>\$ 255,330</u> |

The Company uses the straight-line method of depreciation over 3 to 5 years. During the quarters ended March 31, 2015 and 2014 depreciation expense charged to operations was \$15,000 and \$42,036, respectively.

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 2014.

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 2014 or 2013.

License costs capitalized as of March 31, 2015 and December 31, 2014 are as follows:

| | March 31, 2015 | December 31, 2014 |
|--------------------------------|---------------------------|----------------------------------|
| License | \$ 100,000 | \$ 100,000 |
| Less: accumulated amortization | 36,764 | 35,293 |
| License, net | <u>\$ 63,236</u> | <u>\$ 64,707</u> |

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 March 31, 2015 and 2014, amortization expense charged to operations was \$1,471 and \$1,471, respectively. Estimated annual amortization for each of the next five years is approximately \$5,900.

Note 7 - Advances Payable – Related Party

As of December 31, 2014, the Company owed Jay Rifkin a current director who is also a former officer of the Company, \$250,000 for unpaid consulting fees accrued prior to the year ended 2011 and accrued interest of \$31,318 accrued on advances made to the company prior to their conversion to promissory notes of the Company on June 30, 2013. As of December 31, 2014, these amounts were accrued in other current liabilities and accrued liabilities on the accompanying condensed consolidated balance sheet, respectively. On January 2, 2015, the Company entered into a Payment of Debt and Release of Claims Agreement and paid the balance of this debt to Mr. Rifkin.

Note 8 - Convertible Notes Payable

The Company has the following convertible notes payable outstanding as of March 31, 2015 and December 31, 2014:

| | <u>2015</u> | <u>2014</u> |
|--|---------------------|---------------------|
| 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 \$1.25 per share. The initial conversion ratio shall be equal to \$1.00 per unit. | \$ 3,408,150 | \$ 3,245,499 |
| 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. | 693,673 | 654,408 |
| 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. | 1,695,000 | 1,705,000 |
| Secured convertible note which matures on July 31, 2018, bear interest at 12% per annum, and 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. | <u>7,777,084</u> | <u>10,475,388</u> |
| Total convertible notes payable before discount | 13,573,907 | 16,080,295 |
| Less discounts | <u>(5,492,975)</u> | <u>(8,275,321)</u> |
| Total convertible notes payable | 8,080,932 | 7,804,974 |
| Less current portion | <u>3,408,150</u> | <u>3,080,376</u> |
| Convertible notes payable, net of current portion | <u>\$ 4,672,782</u> | <u>\$ 4,724,598</u> |

As of March 31, 2015, schedule principal payments due on convertible notes payable are as follows:

| <u>Twelve months ended March 31,</u> | |
|---|-------------------|
| 2016 | 3,408,150 |
| 2017 | 2,568,123 |
| 2018 | 1,908,270 |
| 2019 | <u>5,689,364</u> |
| | <u>13,573,907</u> |

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 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 quarters ended March 31, 2015 and 2014, was \$105,127 and \$83,416, respectively. As of March 31, 2015, total principal of \$3,408,150 was outstanding on these notes and is set to mature during the next twelve months. As of May 15, 2015, the Company and holders of these notes representing approximately \$1,865,000 of the total outstanding principal have 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.

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 quarters ended March 31, 2015 and 2014, was \$14,735 and \$13,114, respectively. As of March 31, 2015, total principal of \$491,156 was outstanding on these notes.

On June 27 and June 30, 2013, the Company converted advances payable from 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. Interest expense for the quarters ended March 31, 2015 and 2014, was \$6,075 and \$5,407, respectively. As of March 31, 2015, total principal of \$202,517 was outstanding on these notes.

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 March 31, 2015 and 2014, was \$42,457 and \$47,222, 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 March 31, 2014 and March 31, 2014 on this discount was \$37,613 and \$69,088, respectively. As of March 31, 2015, total principal of \$1,695,000 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. As of December 31, 2014, the Company was not in compliance with a certain covenant and received a waiver from Lender for this failure on March 16, 2015 in association with an amendment to the Financing Agreement.

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. Interest expense for the quarter ended March 31, 2015 was \$301,696. As of March 31, 2015, total principal of \$7,777,084 was outstanding on this note. In connection with change in the conversion terms and repayment of principal, the Company incurred a loss of \$2,246,105 which was primarily related to accelerated amortization of the discount on convertible notes payable and is included in interest expense.

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 subsequent to issuance). 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 subsequent to the issuance). 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, 2014, per a new valuation performed in accordance with FASB ASC 815-10, the total value of these warrants was adjusted to \$5,597,011 and a gain for the change in value of the liability of \$4,204,189 was recognized. As of March 31, 2015, pursuant to a new valuation performed in accordance with FASB ASC 815-10, the total value of these warrants was adjusted to \$7,475,561 and a loss for the change in value of the liability of \$1,878,550 was recognized.

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:

| For the year ended December 31 | |
|---------------------------------------|--------------------|
| 2015 | \$ 225,000 |
| 2016 | 300,000 |
| 2017 | 300,000 |
| 2018 | 300,000 |
| 2019 | 300,000 |
| Thereafter | <u>1,750,000</u> |
| | <u>\$3,175,000</u> |

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 36 month lease for warehouse space in Centralia, Washington, commencing August 1, 2011. The lease provides for the option to extend the lease on a month to month basis. Rent is \$1,900 monthly throughout the term of the lease.

On June 1, 2014, the Company entered into a seven month lease for warehouse space in Fairfield, Texas, commencing June 1, 2014. The lease provides for the option to extend the lease on a month to month basis. Rent is \$3,000 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. Future minimum lease payments under this non-cancelable lease in 2015 and 2016 are \$13,780 and \$2,758, respectively.

The Company also leases office space in Grand Forks, ND, which has a renewable annual term and requires quarterly rental payments of \$1,631.

Rent expense was approximately \$28,000 and \$12,000 for the quarters ended March 31, 2015 and 2014, 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.

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, 2015, the Company issued 170,500 shares of common stock to the holders of notes with a term of three years, bearing 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, 2014.

On January 30, 2015, the Company issued 20,161 shares of common stock upon the conversion of a note with principal totaling \$10,000 and accrued interest of \$81, that bears interest at 10% per annum, and was convertible into one share of common stock, par value \$0.001 per share, with a conversion ratio equal to \$0.50 per share.

On February 20, 2015, the Company issued 32,604 shares of common stock and 8,151 warrants to purchase shares of common stock upon the conversion of a note principal and accrued interest totaling \$32,603, that bear interest at 12% per annum, and was convertible into units, where each unit consists of: (i) one share of common stock, par value \$0.001 per share, and (ii) a warrant to purchase 0.25 shares of common stock at an exercise price of \$1.25 per share with a conversion ratio equal to \$1.00 per unit.

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.

A summary of stock option activity for the quarter ended March 31, 2015 is presented below:

| | Number of Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Life (years) | Aggregate Intrinsic Value |
|-------------------------|---------------------|--|---|---------------------------------|
| December 31, 2014 | 5,095,458 | 1.70 | 4.5 | - |
| Grants | 250,000 | 0.61 | 4.7 | - |
| Cancellations | - | - | - | - |
| March 31, 2015 | 5,345,458 | 1.65 | 4.2 | - |
| Options exercisable at: | | | | |
| December 31, 2014 | 3,095,458 | 2.31 | 4.3 | |
| March 31, 2015 | 3,095,458 | 2.31 | 4.0 | |

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 72.8%, 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 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. Based on a Black-Scholes valuation model, the value of the issued options was \$910,350 in accordance with FASB ASC Topic 718. Compensation expense for the quarter ended March 31, 2015 on the issued options was \$113,793.

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. Based on a Black-Scholes valuation model, these options were valued at \$93,803 in accordance with FASB ASC Topic 718. Compensation expense for the quarter ended March 31, 2015 on the issued options was \$11,735.

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 72.8%, 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.

On February 20, 2015, the Company issued 8,151 warrants to purchase shares of common stock upon the conversion of a note principal and accrued interest totaling \$32,603 (see Note 11).

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.

The following table summarizes information about common stock warrants outstanding at March 31, 2015:

| Outstanding | | | Exercisable | | |
|-----------------------|---------------------------|--|-----------------------|---------------------------|--|
| Exercise Price | Number Outstanding | Weighted Average Remaining Contractual Life (years) | Exercise Price | Number Exercisable | Weighted Average Exercise Price |
| \$ 3.30 | 11,364 | 1.12 | \$ 3.30 | 11,364 | \$ 3.30 |
| 1.25 | 40,252 | 1.10 | 1.25 | 40,252 | 1.25 |
| 1.00 | 24,000 | 1.57 | 1.00 | 24,000 | 1.00 |
| 0.88 (1) | 1,303,300 | 4.11 | 0.88 | 1,303,300 | 0.88 |
| 0.84 (2) | 959,508 | 4.38 | 0.84 | 959,508 | 0.84 |
| 0.75 | 435,271 | 0.28 | 0.75 | 435,271 | 0.75 |
| 0.67 (3) | 3,805,000 | 3.53 | 0.67 | 3,805,000 | 0.67 |
| 0.50 | 14,077,750 | 4.34 | 0.50 | 14,077,750 | 0.50 |
| 0.50 - | | | | | |
| \$ 3.30 | 20,656,445 | 4.33 | | 20,656,445 | |

Note (1) On March 16, 2015, per the anti-dilution adjustment impact of an amendment to the Financing Agreement executed on that date, the conversion price for these warrants was decreased from \$1.05 to \$0.88.

Note (2) On March 16, 2015, per the anti-dilution adjustment impact of an amendment to the Financing Agreement executed on that date, the number of shares to be purchased with these warrants was increased from 809,974 to 959,508 shares and the conversion price was decreased from \$0.99 to \$0.84.

Note (3) On March 16, 2015, per the anti-dilution adjustment impact of an amendment to the Financing Agreement executed on that date, the conversion price for these warrants was decreased from \$0.75 to \$0.67.

Note 14 - Tax

For the quarter ended March 31, 2015, 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, 2014, the Company's net operating loss carryforward was approximately \$21,132,000. 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 2025.

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 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, current directors of the Company, under the Company's Equity Plan. 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. The options are fully vested and exercisable as of the date of grant 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 May 4, 2015, the Company issued nonqualified stock options to acquire 25,000 shares each of the Company's common stock to Jay Rifkin and Brian Johnson, nonqualified stock options to acquire 50,000 shares of the Company's common stock to Chris Lee and nonqualified stock options to acquire 75,000 shares of the Company's common stock to Chris Greenberg, current directors of the Company, under the Company's Equity Plan. The options are granted and 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. The options 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 \$74,990 in accordance with FASB ASC Topic 718.

From May 6 through May 15, 2015, the Company and holders of unsecured 12.0% Convertible Promissory Notes (the "Notes") representing approximately \$1,865,000 of the total outstanding principal have entered into amendments (the "First Note Amendment") to the Notes which (i) extend the Maturity Date of the Notes 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.

On May 8, 2015, the Company issued 103,528 shares of common stock upon the conversion of a note with principal totaling \$50,000 and accrued interest of \$1,764, that bears interest at 10% per annum, and was convertible into one share of common stock, par value \$0.001 per share, with a conversion ratio equal to \$0.50 per share.

From April 28 through May 15, 2015, the Company issued 481,216 shares of common stock and 120,304 warrants to purchase shares of common stock upon the conversion of a note principal and accrued interest totaling \$240,608, that bear interest at 12% per annum, and was convertible into units, where each unit consists of: (i) share of common stock, par value \$0.001 per share, and (ii) a warrant to purchase 0.25 shares of common stock at an exercise price of \$1.00 per share with a conversion ratio equal to \$0.50 per unit.

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

Background

Midwest Energy Emissions Corp. develops and deploys patented and proprietary technologies to remove mercury from coal-fired power plant air emissions. The U.S. EPA MATS 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. In general, MATS requires EGUs to remove about 90% of the mercury from their emissions. Our technology has been shown to be able to achieve mercury removal levels compliant with MATS and at a lower cost and plant impact than the most widely used approach of PAC or BAC injection. 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 periodically, (monthly or as material is delivered) based on their actual use of our injected material. Clients will use this material whenever their EGUs operate, 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.

Results of Operations

The first fiscal quarter of 2015 was a quarter which focused on intense contract implementation, sales and marketing. During the quarter, the Company deployed resources towards execution on the currently contracted business, construction and implementation of proprietary mobile feeder systems that will enhance technology-demonstration flexibility. In addition, during the quarter, the Company adjusted to an environment that saw a large percentage of current and prospective customers receive, in the latter part of 2014, extensions for compliance for MATS until 2016.

The Company focused on execution in this first quarter, responding to contract and testing demands of its customer base, while actively marketing and selling its patented SEA Technology to the vast number of utilities seeking compliance in 2016. The previously announced customer contracts of 2014 include designing and installing front-end injection equipment, called skids, for injection of our proprietary front-end product, and some include installation of an additional back-end system, called an ACI, if a customer does not already have one, for injection of our back-end product. All of this, we estimate, will generate over \$8 million in equipment sales during 2015, and the Company estimates that it will begin to accrue revenues from these installations, as well as customer contracts for MATS compliance, in the second quarter. Based upon all available information and Company estimates, the contracts that are in place currently – which amount to 15 EGU's, and with 5 separate utilities or electric-cooperatives – are estimated to exceed \$110 million in aggregate revenues over the five year span of these contracts.

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") due to the failure of certain financial covenants. 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 on March 16, 2015, reducing the principal outstanding to \$7,735,826. 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. The Company believes that this amendment will allow it to move forward with the necessary working capital to implement its business plan with the anticipation of becoming cash flow positive when our customers begin full MATS compliance activities in 2016.

Revenues

Sales - We generated revenues for delivered product of approximately \$243,000 and \$0 for the quarters ended March 31, 2015 and 2014, respectively.

Cost and Expenses

Costs and expenses were \$1,489,000 and \$3,104,000 during the quarters ended March 31, 2015 and 2014, respectively. The decrease in costs and expenses from the prior year is primarily attributable to a decrease in stock based compensation issued to employees and directors of approximately \$2 million during the current quarter compared to the same period in the prior year. The decrease is offset by an increase in 2015 of operating expenses and cost of goods sold.

Cost of goods sold during the quarters ended March 31, 2015 and 2014 was \$150,000 and \$0, respectively. The increase in cost is attributable to the increase in product sales in the first three months of 2015.

Operating expenses during the quarters ended March 31, 2015 and 2014 were \$347,000 and \$21,000, respectively. The increase in operating costs from the prior year is primarily attributable to increased labor and technical consulting costs associated with assisting our customers with testing and equipment commissioning being performed at their sites and increased salary and overhead costs associated with an increase in our operations staff from the prior year.

License Maintenance Fees were \$75,000 and \$75,000 for the quarters ended March 31, 2015 and 2014, respectively. The expenses relate to the monthly amortization of the annual maintenance fee.

Selling, general and administrative expenses were \$556,000 and \$544,000 for the quarters ended March 31, 2015 and 2014, respectively. The increase in selling, general and administrative expenses is primarily attributed to increases in payroll and benefits, and insurance expenses associated with the expansion of our business, offset by decreased investor relation costs.

Depreciation and amortization expenses were \$66,000 and \$44,000 for the quarters ended March 31, 2015 and 2014, respectively. The increase from the prior year is attributable to amortization of customer acquisitions costs.

Professional fee expenses were \$170,000 and \$233,000 for the years March 31, 2015 and 2014, respectively. The decrease in professional fee expenses is attributed to a decrease in professional fees related to the maintenance, expansion and defense of our intellectual property.

Stock based compensation was \$126,000 and \$2,189,000 for the quarters ended March 31, 2015 and 2014, respectively. In the quarter ended March 31, 2014, these costs were associated with stock options issued to officers, directors and consultants. In the quarter ended March 31, 2015, these costs were associated with the stock options included in the employment agreements of two new employees.

Other Expenses

Given our financial constraints and our reliance on financing activities, interest expense related to the financing of capital was \$3,422,000 and \$298,000 during the quarters ended March 31, 2015 and 2014, respectively. In connection with the change in the conversion terms and repayment of principal per the Amendment with AC Midwest Energy, LLC, the Company incurred a loss of \$2,246,105 which was primarily related to accelerated amortization of the discount on convertible notes payable and is included in interest expense. Also, during the quarter ended March 31, 2015, a loss on the change in value of warrant liability of \$1,879,000 was incurred.

Net Loss

For the quarters ended March 31, 2015 and 2014, we had a net loss of approximately \$6,568,000 and \$3,402,000, respectively. The increased net loss is primarily attributed to (i) increased interest expense; (ii) a loss on the change in value of warrant liability; (iii) a loss on the change in value of convertible notes payable, and; (iv) increased operations expenses incurred offset by decreased stock based compensation expense in the current quarter from the prior year.

Taxes

As of March 31, 2015, 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 2025.

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.

Liquidity and Capital Resources

Our principal source of liquidity is cash generated from financing activities. As of March 31, 2015, our cash and cash equivalents totaled \$2,014,000. In March 2015, pursuant to an amendment of its Financing Agreement with AC Midwest, LLC, the Company repaid \$3,000,000 of outstanding principal. The high volume product supply revenue that we expected to begin in 2015, has been delayed until 2016 as a result of one year MATS compliance waivers granted by their state EPA on seven units under contract. Our anticipated cash needs for working capital and capital expenditures for the next twelve months are approximately \$4.0 million. We have primarily relied upon financing activities to fund our operations. Although we anticipate significant revenues for the sale of capital equipment and products to be used in testing and commissioning work done by clients, no assurances can be given that the Company can obtain sufficient working capital through financing 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. Convertible notes with current principal balances of approximately \$3,200,000 and \$900,000 mature in 2015 and 2016, respectively. As of May 15, 2015, the Company extended principal balances on these notes totaling approximately \$1,865,000 through executed amendment agreements with the note holders. The Company is in the process of seeking such amendments from the remaining note holders, approximately \$400,000 of which have reached maturity, but there can be no assurance that all remaining holders will accept the offered extension terms. The notes of any holders who do not accept will be governed by the original terms thereof. Therefore, success in our fund raising efforts and negotiations with our note holders is crucial. We are actively seeking sources of additional financing in order to fund our debt repayment obligations and if extensions cannot be negotiated with our early investors who purchased convertible debt from the Company. Due to these efforts, we could dilute current shareholders and the dilution could be significant. Our current cash flow needs for general overhead, sales and operations is approximately \$300,000 per month with additional funds often needed for demonstrations of our technology on potential customer units. With our expected gross margins on customer contracts, we anticipate we will be at break-even on a cash flow basis when our product revenues reach approximately \$16 million annually. This break-even target is subject to achieving sales at that level with our expected gross margins. No assurance can be made that we will be able to achieve this target.

Total assets were \$14,536,000 at March 31, 2015 versus \$17,325,000 at December 31, 2014. The change in total assets is primarily attributable to the decreases in cash and is offset by the increases in inventory associated with costs of beginning to fabricate the equipment our customers will need to install at their individual sites and accounts receivable associated with billing our customers for these projects.

Total liabilities were \$25,416,000 at March 31, 2015 versus \$21,909,000 at December 31, 2014. During the quarter ended March 31, 2015, the Company repaid \$3,000,000 of outstanding principal on secured notes payable. Deferred revenue continued to increase as equipment projects continued towards completion and commissioning at its customer sites. Also, after the amendment to the finance agreement and warrants issued to the Company's largest secured lender, the fair value of the convertible note payable increased as did the fair value of the warrant liability.

Operating activities used \$1,685,000 of cash during the quarter ended March 31, 2015 compared to \$246,000 during the quarter ended March 31, 2014. The change in cash used for operating activities is primarily attributable to the increase in net loss and equipment inventory and is offset by increases in amortization and deferred revenue.

Investing activities used \$513,000 and \$0 during the quarters ended March 31, 2015 and 2014, respectively. In 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 this increase.

Financing activities provided \$8,000 during the quarter ended March 31, 2014 due to proceeds from the exercise of a warrant to purchase shares of common stock. Financing activities used \$3,000,000 during the quarter ended March 31, 2015 due to the repayment of principal of convertible promissory notes.

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 March 31, 2015 have been prepared assuming the Company will continue as a going concern. The Company has experienced a net loss, negative cash flows from operations and has an accumulated deficit of \$30,306,209. Late in 2014, our customers received one-year extensions on seven of our contracted units to their MATS compliance date which we previously expected to be in compliance in 2015. On March 16, 2015, pursuant to an amendment of the Financing Agreement with AC Midwest Energy, LLC, the Company repaid \$3,000,000 of outstanding convertible note principal (see Note 8). These factors raise substantial doubt about the Company's ability to continue as a going concern. Although we anticipate significant revenues for the sale of capital equipment and products to be used in testing and commissioning work done by clients, no assurances can be given that the Company can obtain sufficient working capital through financing 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. Convertible notes with current principal balances of approximately \$3,200,000 and \$900,000 mature in 2015 and 2016, respectively. Therefore, success in our fund raising efforts and negotiations with our note holders is crucial. We are actively seeking sources of additional financing in order to fund our debt repayment obligations and 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. As of May 15, 2015, convertibles notes with principal balances totaling approximately \$1,865,000 were extended through executed amendment agreements with the current convertible note holders. The Company is in the process of seeking such amendments from the remaining note holders, approximately \$400,000 of which have reached maturity, but there can be no assurance that all remaining holders will accept the offered extension terms. The notes of any holders who do not accept will be governed by the original terms thereof.

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.

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 March 31, 2015 or December 31, 2014. 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 2011 or state tax examinations for years prior to 2010. Prior to the Reverse Merger, MES, Inc. was taxed as an S corporation and income and losses were passed through to the stockholders.

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.

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 72.8%, 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.

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 the Principal Executive Officer (“PEO”) and Principal Financial Officer (“PFO”), 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 the PEO and PFO, to allow timely decisions regarding required disclosures.

Based on that evaluation, the PEO and PFO concluded, as of the end of the period covered by this report, that the Company’s disclosure controls and procedures were not effective due to a deficiency in the evaluation of items that may need to be reported by the Company under a Current Report on Form 8-K. Management intends to address this deficiency by improving controls over segregation of duties and management activities, and taking other measures that may be necessary and advisable.

Changes in Internal Control over Financial Reporting

There have been no changes in the Company’s internal control over financial reporting during the quarter ended March 31, 2015 that have materially affected or are reasonably likely to materially affect the Company’s internal control over financial reporting.

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

Not applicable

ITEM 3 - DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4 - MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5 - OTHER INFORMATION

Not applicable

ITEM - 6 EXHIBITS

Exhibit

| <u>Number</u> | <u>Description</u> |
|---------------|--|
| 10.1 | Waiver and Amendment to Financing Agreement, and Reaffirmation of Guaranty between Midwest Energy Emissions Corp., MES, Inc. and AC Midwest Energy, LLC dated as of March 16, 2015 (1) |
| 10.2 | Amendment No. 1 to Warrant for 12,500,000 Shares issued to AC Midwest Energy, LLC dated as of March 16, 2015 (1) |
| 10.3* | Payment of Debt and Release of Claims Agreement between Midwest Energy Emissions Corp. and Jay Rifkin dated as of January 2, 2015 |
| 31.1* | Certification by Chief Executive Officer, required by Rule 13a-14(a) or Rule 15d-14(a) of the Exchange Act |
| 31.2* | Certification by Chief Financial Officer, required by Rule 13a-14(a) or Rule 15d-14(a) of the Exchange Act |
| 32.1* | 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 |
| 32.2* | 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 |
| 101* | The following financial information from our Quarterly Report on Form 10-Q for the three months ended March 31, 2015 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) Condensed Consolidated Statements of Cash Flows, and (v) Notes to Condensed Consolidated Financial Statements |

* Filed herewith.

(1) Incorporated by reference to Form 10-K filed March 20, 2015.

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: May 15, 2015

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

Dated: May 15, 2015

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

PAYMENT OF DEBT AND RELEASE OF CLAIMS AGREEMENT

This Payment of Debt and Release of Claims Agreement (“*Agreement*”) is entered into by and between MIDWEST ENERGY EMISSIONS CORP., a Delaware corporation (the “*Company*”) on behalf of itself, its subsidiaries and other corporate affiliates (collectively referred to herein as the “*Company Group*”), and JAY RIFKIN (“*Rifkin*”) (the Company Group and Rifkin are collectively referred to herein as the “*Parties*”) as of January 2, 2015 (the “*Effective Date*”).

RECITALS

1. Rifkin was the Chief Executive Officer of China Youth Media, Inc. from 2005 until June 21, 2011, when he resigned from that position shortly after the effective date of that certain Agreement and Plan of Merger (“*Merger Agreement*”) by and among China Youth Media, Inc., a Delaware Corporation (“*CHYU*”), China Youth Media Merger Sub, Inc., a Delaware corporation and wholly owned subsidiary of CHYU, and Midwest Energy Emissions Corp., a North Dakota corporation, dated as of June 1, 2011.

2. Rifkin has been a director of the board of the Company since 2006.

3. The Company owes Rifkin \$250,000 of accrued consulting fees (“*Consulting Fees*”) and \$31,318 in accrued interest relating to interest accrued on certain other advances made by Rifkin to CHYU and the Company prior to the date hereof (“*Accrued Interest*”).

4. The Company has agreed to pay Rifkin a total of \$281,318 in cash upon the execution and delivery of this Agreement.

NOW THEREFORE, in consideration of the mutual promises, covenants and agreements hereinafter set forth and of other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the Parties agree as follows:

AGREEMENT

Final Payment. In consideration for Rifkin’s execution of and compliance with this Agreement the Company Group agrees to immediately pay Rifkin a lump sum of \$281,318 to be paid by wire transfer on the Effective Date.

Release. In exchange for the consideration provided in this Agreement, Rifkin and his heirs, executors, representatives, agents, successors and assigns (collectively, the “*Rifkin Releasors*”), release and discharge the Company Group from the Consulting Fees and the Accrued Interest as defined herein. Company Group, upon mutual execution of this Agreement, shall release and discharge the Rifkin Releasors from providing any further consulting services to the Company Group.

IN WITNESS WHEREOF, the Parties have executed this Agreement as of the Effective Date above.

MIDWEST ENERGY EMISSIONS CORP.

500 West Wilson Bridge Road, Suite 140
Worthington, OH 43085

By: /s/ R. Alan Kelley

Name: R. Alan Kelley

Title: Chief Executive Officer

By: /s/ Jay Rifkin

Name: Jay Rifkin

CERTIFICATION

I, Richard MacPherson, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Midwest Energy Emissions Corp.;
2. Based on my knowledge, this report does not contain any untrue statements of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation;
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonable likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: May 15, 2015

By: /s/ Richard MacPherson
Richard MacPherson, Chief Executive
Officer
(Principal Executive Officer)

CERTIFICATION

I, Richard H. Gross, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Midwest Energy Emissions Corp.;
2. Based on my knowledge, this report does not contain any untrue statements of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation;
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonable likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: May 15, 2015

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

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE
SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Midwest Energy Emissions Corp. (the "Company") on Form 10-Q for the period ended March 31, 2015, as filed with the Securities and Exchange Commission (the "Report"), the undersigned certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to the best of the undersigned's knowledge, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: May 15, 2015

By: /s/ Richard MacPherson
Richard MacPherson, Chief Executive
Officer
(Principal Executive Officer)

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE
SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Midwest Energy Emissions Corp. (the "Company") on Form 10-Q for the period ended March 31, 2015, as filed with the Securities and Exchange Commission (the "Report"), the undersigned certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to the best of the undersigned's knowledge, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: May 15, 2015

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