

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 September 30, 2020

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.)

1810 Jester Drive
Corsicana, Texas

(Address of principal Executive offices)

75109

(Zip Code)

(614) 505-6115

(Registrant's Telephone Number, Including Area Code)

Not applicable

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

Securities registered pursuant to Section 12(b) of the Act: None.

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 every Interactive Data File required to be submitted 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 such files). Yes No

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

Large accelerated filer

Non-accelerated filer

Accelerated filer

Smaller reporting company

Emerging growth company

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

Indicate by check mark whether the registrant is a shell company (as defined 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 78,047,750 outstanding as of November 23, 2020.

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 27A of the Securities Act of 1933, as amended, and 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 2019 Form 10-K. In addition, matters that may cause actual results to differ materially from those in the forward-looking statements include, among other factors, the gain or loss of a major customer, change in environmental regulations, disruption in supply of materials, capacity factor fluctuations of power plant operations and power demands, a significant change in general economic conditions in any of the regions where our customer utilities might experience significant changes in electric demand, a significant disruption in the supply of coal to our customer units, the loss of key management personnel, availability of capital and any major litigation regarding the Company.

Except as expressly required by the federal securities laws, we undertake no obligation to update such factors or to publicly announce the results of any of the forward-looking statements contained herein to reflect future events, developments, or changed circumstances or for any other reason. Investors are cautioned that all forward-looking statements involve risks and uncertainties, including those detailed in the Company’s filings and with the Securities and Exchange Commission.

Item 1. Financial Information.

MIDWEST ENERGY EMISSIONS CORP. AND SUBSIDIARY
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As of and for the three and nine months ended September 30, 2020

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MIDWEST ENERGY EMISSIONS CORP. AND SUBSIDIARY
CONDENSED CONSOLIDATED BALANCE SHEETS
SEPTEMBER 30, 2020 AND DECEMBER 31, 2019
(UNAUDITED)

| | September 30, | December 31, |
|--|----------------------|---------------------|
| | 2020 | 2019 |
| | (Unaudited) | (Unaudited) |
| ASSETS | | |
| Current assets | | |
| Cash | \$ 318,931 | \$ 1,499,287 |
| Accounts receivable | 1,474,952 | 1,222,874 |
| Inventory | 473,560 | 513,498 |
| Prepaid expenses and other assets | 185,248 | 316,199 |
| Total current assets | 2,452,691 | 3,551,858 |
| Property and equipment, net | 1,918,226 | 2,082,343 |
| Right of use asset | 894,203 | 1,106,575 |
| Intellectual property | 2,369,946 | 2,532,462 |
| Total assets | \$ 7,635,066 | \$ 9,273,238 |
| LIABILITIES AND STOCKHOLDERS' DEFICIT | | |
| Current liabilities | | |
| Accounts payable and accrued expenses (related party of \$131,250 and \$43,750) | \$ 1,617,465 | \$ 1,676,757 |
| Current portion of equipment notes payable | 30,233 | 53,304 |
| Current portion of operating lease liability | 402,918 | 383,307 |
| Note payable | 85,585 | - |
| Current portion of convertible notes payable | - | 990,000 |
| Accrued interest | 140,346 | 226,065 |
| Customer credits | 167,000 | 167,000 |
| Accrued salaries | 706,989 | 357,095 |
| Total current liabilities | 3,150,536 | 3,853,528 |
| Equipment notes payable, less current portion | 8,293 | 22,386 |
| Operating lease liability | 498,535 | 807,409 |
| Note payable | 299,300 | - |
| Convertible notes payable, net of discount and issuance costs | 4,026,378 | 2,951,137 |
| Profit share liability – related party | 2,187,891 | 2,328,845 |
| Secured note payable – related party | 271,686 | 271,686 |
| Unsecured note payable, net of discount and issuance costs – related party | 9,395,979 | 7,911,898 |
| Total liabilities | 19,838,598 | 18,146,889 |
| COMMITMENTS AND CONTINGENCIES (Note 11) | | |
| Stockholders' deficit | | |
| Preferred stock, \$0.001 par value: 2,000,000 shares authorized | - | - |
| Common stock; \$0.001 par value; 150,000,000 shares authorized; 77,747,750 and 76,747,750 shares issued and outstanding as of September 30, 2020 and December 31, 2019, respectively | 77,748 | 76,748 |
| Additional paid-in capital | 49,179,979 | 48,708,085 |
| Accumulated deficit | (61,461,259) | (57,658,484) |
| Total stockholders' deficit | (12,203,532) | (8,873,651) |
| Total liabilities and stockholders' deficit | \$ 7,635,066 | \$ 9,273,238 |

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

MIDWEST ENERGY EMISSIONS CORP. AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE MONTHS AND NINE MONTHS ENDED SEPTEMBER 30, 2020 AND 2019
(UNAUDITED)

| | For the Three Months Ended September 30, 2020 | For the Three Months Ended September 30, 2019 | For the Nine Months Ended September 30, 2020 | For the Nine Months Ended September 30, 2019 |
|---|--|--|---|---|
| Revenues | \$ 2,812,197 | \$ 3,596,107 | \$ 5,812,375 | \$ 8,893,177 |
| Costs and expenses: | | | | |
| Cost of sales | 1,881,742 | 2,477,673 | 4,198,125 | 6,438,998 |
| Selling, general and administrative expenses (related party of \$75,000, \$76,991, \$200,000 and \$227,530) | 1,271,351 | 1,186,280 | 3,576,796 | 5,116,487 |
| Interest expense & letter of credit fees (related party of \$509,300, \$508,886, \$1,514,735 and \$1,450,215) | 672,355 | 623,237 | 1,987,102 | 1,690,855 |
| (Gain) loss on change in fair value of profit share | 111,436 | 112,575 | (140,954) | 255,847 |
| Gain on sale of equipment | - | - | (5,919) | - |
| Total costs and expenses | <u>3,936,884</u> | <u>4,399,765</u> | <u>9,615,150</u> | <u>13,502,187</u> |
| Loss before provision for income taxes | (1,124,687) | (803,658) | (3,802,775) | (4,609,010) |
| Provision for income taxes | - | - | - | - |
| Net loss | <u>\$ (1,124,687)</u> | <u>\$ (803,658)</u> | <u>\$ (3,802,775)</u> | <u>\$ (4,609,010)</u> |
| Net loss per common share-basic and diluted: | <u>\$ (0.01)</u> | <u>\$ (0.01)</u> | <u>\$ (0.05)</u> | <u>\$ (0.06)</u> |
| Weighted average common shares outstanding - basic and diluted | <u>77,747,750</u> | <u>76,730,400</u> | <u>77,744,087</u> | <u>76,463,246</u> |

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

MIDWEST ENERGY EMISSIONS CORP. AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIT
FOR THE THREE MONTHS AND NINE MONTHS ENDED SEPTEMBER 30, 2020 AND 2019
(UNAUDITED)

Nine Months Ended September 30, 2020

| | <u>Common Stock</u> | | <u>Additional Paid-in Capital</u> | <u>Accumulated (Deficit)</u> | <u>Total</u> |
|-------------------------------------|---------------------|------------------|---|----------------------------------|------------------------|
| | <u>Shares</u> | <u>Par Value</u> | | | |
| Balance - January 1, 2020 | 76,747,750 | \$ 76,748 | \$ 48,708,085 | \$ (57,658,484) | \$ (8,873,651) |
| Stock issued for prepaid services | 1,000,000 | 1,000 | 199,000 | - | 200,000 |
| Net loss | - | - | - | (1,773,871) | (1,773,871) |
| Balance - March 31, 2020 | <u>77,747,750</u> | <u>77,748</u> | <u>48,907,085</u> | <u>(59,432,355)</u> | <u>(10,447,522)</u> |
| Issuance of stock options | - | - | 19,921 | - | 19,921 |
| Net loss | - | - | - | (904,217) | (904,217) |
| Balance - June 30, 2020 | <u>77,747,750</u> | <u>77,748</u> | <u>48,927,006</u> | <u>(60,336,572)</u> | <u>(11,331,818)</u> |
| Issuance of stock options | - | - | 252,973 | - | 252,973 |
| Net loss | - | - | - | (1,124,687) | (1,124,687) |
| Balance - September 30, 2020 | <u>77,747,750</u> | <u>\$ 77,748</u> | <u>\$ 49,179,979</u> | <u>\$ (61,461,259)</u> | <u>\$ (12,203,532)</u> |

Nine Months Ended September 30, 2019

| | <u>Common Stock</u> | | <u>Additional Paid-in Capital</u> | <u>Accumulated (Deficit)</u> | <u>Total</u> |
|--|---------------------|------------------|---|----------------------------------|-----------------------|
| | <u>Shares</u> | <u>Par Value</u> | | | |
| Balance - January 1, 2019 | 76,246,113 | \$ 76,246 | \$ 42,785,990 | \$ (51,483,332) | \$ (8,621,096) |
| Cumulative effect of change in accounting principle related to accounting for leases | - | - | - | (77,866) | (77,866) |
| Capital contribution related to debt restructuring | - | - | 3,412,204 | - | 3,412,204 |
| Net loss | - | - | - | (1,058,779) | (1,058,779) |
| Balance - March 31, 2019 | <u>76,246,113</u> | <u>\$ 76,246</u> | <u>\$ 46,198,194</u> | <u>\$ (52,619,977)</u> | <u>\$ (6,345,537)</u> |
| Stock issued per resignation agreements | 464,517 | 464 | 118,076 | - | 118,540 |
| Issuance of stock options | - | - | 898,207 | - | 898,207 |
| Extension of certain stock option expiration dates | - | - | 745,989 | - | 745,989 |
| Issuance of warrants, recorded as discount on convertible notes payable | - | - | 197,664 | - | 197,664 |
| Net loss | - | - | - | (2,746,573) | (2,746,573) |
| Balance - June 30, 2019 | <u>76,710,630</u> | <u>\$ 76,710</u> | <u>\$ 48,158,130</u> | <u>\$ (55,366,550)</u> | <u>\$ (7,131,710)</u> |
| Stock issued upon cashless warrant exercise | 37,120 | 37 | (37) | - | - |
| Issuance of warrants, recorded as discount on convertible notes payable | - | - | 136,320 | - | 136,320 |
| Net loss | - | - | - | (803,658) | (803,658) |
| Balance - September 30, 2019 | <u>76,747,750</u> | <u>\$ 76,747</u> | <u>\$ 48,294,413</u> | <u>\$ (56,170,208)</u> | <u>\$ (7,799,048)</u> |

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

**MIDWEST ENERGY EMISSIONS CORP. AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2020 AND 2019
(UNAUDITED)**

| | For the Nine Months Ended September 30, 2020 | For the Nine Months Ended September 30, 2019 |
|--|---|---|
| Cash flows from operating activities | | |
| Net loss | \$ (3,802,775) | \$ (4,609,010) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Stock-based compensation – amortization of prepaid services | 619,176 | 1,762,736 |
| Amortization of discount of notes payable | 1,477,771 | 1,200,780 |
| Amortization of debt issuance costs | 91,551 | 99,515 |
| Amortization of right to use assets | 212,372 | 283,551 |
| Amortization of customer acquisition costs | - | 34,467 |
| Amortization of patent rights | 162,516 | 150,900 |
| Depreciation expense | 160,537 | 247,954 |
| Gain on sale of equipment | (5,919) | - |
| (Gain) Loss on change in fair value of profit share | (140,954) | 255,847 |
| Changes in operating assets and liabilities | | |
| (Increase) Decrease in accounts receivable | (252,078) | 211,060 |
| (Increase) Decrease in inventory | 39,938 | (120,011) |
| Increase in prepaid expenses and other assets | (15,331) | (119,785) |
| Increase (Decrease) in accounts payable and accrued liabilities | 204,882 | (424,686) |
| Decrease in operating lease liability | (289,263) | (277,944) |
| Net cash used in operating activities | <u>(1,537,577)</u> | <u>(1,304,626)</u> |
| Cash flows provided by investing activities | | |
| Cash received from sale of equipment | 9,500 | - |
| Net cash provided by investing activities | <u>9,500</u> | <u>-</u> |
| Cash flows from financing activities | | |
| Payment of debt issuance costs | - | (46,683) |
| Payments of notes payable | (114,415) | (59,672) |
| Payments of equipment notes payable | (37,164) | - |
| Proceeds from the issuance of convertible promissory notes and related warrants | - | 1,825,000 |
| Proceeds from the issuance of notes payable | 499,300 | - |
| Net cash provided by financing activities | <u>347,721</u> | <u>1,718,645</u> |
| Net increase (decrease) in cash and cash equivalents | (1,180,356) | 414,019 |
| Cash and cash equivalents - beginning of period | 1,499,287 | 584,877 |
| Cash and cash equivalents - end of period | <u>\$ 318,931</u> | <u>\$ 998,896</u> |
| SUPPLEMENTAL CASH FLOW INFORMATION: | | |
| Cash paid during the period for: | | |
| Interest | \$ 488,265 | \$ 237,575 |
| Taxes | \$ - | \$ - |
| SUPPLEMENTAL DISCLOSURE OF NON-CASH TRANSACTIONS | | |
| Cumulative effect on accumulated deficit of lease accounting change | \$ - | \$ 77,866 |
| Stock issued for prepaid services | \$ 200,000 | \$ - |
| Discount on convertible promissory notes payable | \$ - | \$ 333,984 |
| Net adjustment for extension of lease | \$ - | \$ 145,267 |
| Capital contribution related to debt restructuring | \$ - | \$ 3,412,204 |

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

**MIDWEST ENERGY EMISSIONS CORP. AND SUBSIDIARY
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 Rule 8-03 of Regulation S-X promulgated by 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, 2019 filed on May 14, 2020, from which the accompanying condensed consolidated balance sheet dated December 31, 2019 was derived.

In management's opinion, the unaudited condensed consolidated financial statements reflect all adjustments necessary to present fairly the financial position as of September 30, 2020, 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.

Principles of Consolidation

The condensed consolidated financial statements include the accounts of Midwest Energy Emissions Corp. and its wholly-owned subsidiary, MES, Inc. Intercompany balances and transactions have been eliminated in consolidation.

Restatement of previously issued financial statements (unaudited)

On April 13, 2020, the Company concluded that a gain on debt restructuring recognized during the first quarter of 2019 (relating to the New AC Midwest Unsecured Note) should have been accounted for as a capital transaction. Since the New AC Midwest Unsecured Note was held by a related party, the gain should have been recorded as a capital transaction under ASC 470-50-40. The profit-sharing portion also should have been bifurcated from the loan and shown separately on the consolidated balance sheets of the financial statements. For more information please review Note 14 in the Form 10-K filed on May 14, 2020 which includes the restated financial statements. Accordingly, the restated amounts are reflected in the results of operations in this Form 10-Q for the three and nine months ended September 30, 2019.

Use of Estimates

The preparation of condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, valuation of equity issuances and disclosures of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. The Company uses estimates in accounting for, among other items, profit share liability, revenue recognition, allowance for doubtful accounts, stock-based compensation, income tax provisions, excess and obsolete inventory reserve and impairment of intellectual property. Actual results could differ from those estimates.

Recoverability of Long-Lived and Intangible Assets

Long-lived assets and certain identifiable intangibles held and used by the Company are 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 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 property and equipment, right of use asset and intellectual property. No impairment charges were recognized for both of the three and nine months ended September 30, 2020 and 2019.

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 was the only asset measured at fair value on a recurring basis by the Company at September 30, 2020 and December 31, 2019 and is considered to be Level 1.

Financial instruments include cash, accounts receivable, accounts payable, customer credits and short-term debt. The carrying amounts of these financial instruments approximated fair value at September 30, 2020 and December 31, 2019 due to their short-term maturities.

The fair value of the promissory notes payable at September 30, 2020 and December 31, 2019 approximated the carrying amount as the notes were issued during the nine months ended September 30, 2020 and 2019 at interest rates prevailing in the market and interest rates have not significantly changed as of September 30, 2020. The fair value of the promissory notes payable was determined on a Level 2 measurement. Discounts on issued debt, as well as debt issuance costs, are amortized over the term of the individual promissory notes.

The fair value of the profit share liability at September 30, 2020 and December 31, 2019 was calculated using a discounted cash flow model based on estimated future cash payments. The fair value of the profit share liability was determined on a Level 3 measurement. These values are determined using pricing models for which the assumptions utilized management's estimates

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The following tables present the Company's assets and liabilities that are measured at fair value on a recurring basis and are categorized using the fair value hierarchy.

| | Fair Value Measurement as of September 30, 2020 | | | |
|--|--|------------|---------------|--------------|
| | Total | Level 1 | Level 2 | Level 3 |
| Assets: | | | | |
| Cash | \$ 318,931 | \$ 318,931 | \$ - | \$ - |
| Total Assets | \$ 318,931 | \$ 318,931 | \$ - | \$ - |
| Liabilities: | | | | |
| Promissory notes | \$ 14,117,454 | \$ - | \$ 14,117,454 | \$ - |
| Profit share liability – related party | 2,187,891 | - | - | 2,187,891 |
| Total Liabilities | \$ 16,305,345 | \$ - | \$ 14,117,454 | \$ 2,187,891 |

| | Fair Value Measurement as of December 31, 2019 | | | |
|------------------------|---|--------------|---------------|--------------|
| | Total | Level 1 | Level 2 | Level 3 |
| Assets: | | | | |
| Cash | \$ 1,499,287 | \$ 1,499,287 | \$ - | \$ - |
| Total Assets | \$ 1,499,287 | \$ 1,499,287 | \$ - | \$ - |
| Liabilities: | | | | |
| Promissory notes | \$ 12,200,411 | \$ - | \$ 12,200,411 | \$ - |
| Profit share liability | 2,328,845 | - | - | 2,328,845 |
| Total Liabilities | \$ 14,529,256 | \$ - | \$ 12,200,411 | \$ 2,328,845 |

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. At both September 30, 2020 and 2019, there were no material gains or losses recognized.

Revenue Recognition

The Company records revenue in accordance with ASC 606, *Revenue from Contracts with Customers*. 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.

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Revenue is recognized when the Company satisfies its performance obligation under the contract by transferring the promised product to its customer that obtains control of the product. A performance obligation is a promise in a contract to transfer a distinct product to a customer. Most of the Company's contracts have a single performance obligation, as the promise to transfer products or services is not separately identifiable from other promises in the contract and, therefore, not distinct.

Revenue is measured as the amount of consideration the Company expects to receive in exchange for transferring products. As such, revenue is recorded net of returns, allowances, customer discounts, and incentives. Sales and other taxes are excluded from revenues. Invoiced shipping and handling costs are included in revenue. The adoption of this standard did not have a material impact on the Company's financial statements.

Disaggregation of Revenue

The Company generated revenue for the three and nine months ended September 30, 2020, and 2019 by (i) delivering product to its commercial customers, (ii) completing and commissioning equipment projects at commercial customer sites and (iii) performing demonstrations of its technology at customers with the intent of entering into long term supply agreements based on the performance of the Company's products during the demonstrations.

Revenue for product sales is recognized at the point of time in which the customer obtains control of the product, at the time title passes to the customer upon shipment or delivery of the product based on the applicable shipping terms.

Revenue for equipment sales is recognized upon commissioning and customer acceptance of the installed equipment per the terms of the purchase contract.

Revenue for demonstrations and consulting services is recognized when performance obligations contained in the contract have been completed, typically the completion of necessary field work and the delivery of any required analysis per the terms of the agreement.

The following table presents sales by operating segment disaggregated based on the type of product and geographic region for the three months ended September 30, 2020, and 2019.

| | Three months ended September 30, 2020 | | | Three months ended September 30, 2019 | | |
|-------------------------------------|--|-----------------|--------------------|--|---------------|--------------------|
| | United States | International | Total | United States | International | Total |
| Product revenue | \$2,780,638 | \$ - | \$2,780,638 | \$3,505,038 | \$ - | \$3,505,038 |
| Demonstrations & Consulting revenue | 27,000 | - | 27,000 | 40,392 | - | 40,392 |
| Equipment revenue | 1,950 | 2,609 | 4,559 | 50,677 | - | 50,677 |
| | <u>\$2,809,588</u> | <u>\$ 2,609</u> | <u>\$2,812,197</u> | <u>\$3,596,107</u> | <u>\$ -</u> | <u>\$3,596,107</u> |

The following table presents sales by operating segment disaggregated based on the type of product and geographic region for the nine months ended September 30, 2020, and 2019.

| | Nine months ended September 30, 2020 | | | Nine months ended September 30, 2019 | | |
|-------------------------------------|---|-------------------|--------------------|---|-------------------|--------------------|
| | United States | International | Total | United States | International | Total |
| Product revenue | \$5,573,643 | \$ 113,600 | \$5,687,243 | \$8,369,788 | \$ 212,640 | \$8,582,428 |
| Demonstrations & Consulting revenue | 109,372 | - | 109,372 | 146,224 | 95,543 | 241,767 |
| Equipment revenue | 9,394 | 6,366 | 15,760 | 68,982 | - | 68,982 |
| | <u>\$5,692,409</u> | <u>\$ 119,966</u> | <u>\$5,812,375</u> | <u>\$8,584,994</u> | <u>\$ 308,183</u> | <u>\$8,893,177</u> |

Income Taxes

The Company follows the asset and liability method of accounting for income taxes under FASB ASC 740, *Income Taxes*. Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred income tax assets 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 included the enactment date. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized.

FASB ASC 740 prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement of tax positions taken or expected to be taken in a tax return. For those benefits to be recognized, a tax position must be more likely than not to be sustained upon examination by taxing authorities. There were no unrecognized tax benefits as of September 30, 2020 and December 31, 2019. The Company is currently not aware of any issues under review that could result in significant payments, accruals or material deviation from its position. The Company is subject to income tax examinations by major taxing authorities since inception.

In response to the COVID-19 pandemic, the Coronavirus Aid, Relief and Economic Security Act (“*CARES Act*”) was signed into law in March 2020. The CARES Act lifts certain deduction limitations originally imposed by the Tax Cuts and Jobs Act of 2017 (“*2017 Tax Act*”). Corporate taxpayers may carryback net operating losses (“*NOLs*”) originating between 2018 and 2020 for up to five years, which was not previously allowed under the 2017 Tax Act. The CARES Act also eliminates the 80% of taxable income limitations by allowing corporate entities to fully utilize NOL carryforwards to offset taxable income in 2018, 2019 or 2020. Taxpayers may generally deduct interest up to the sum of 50% of adjusted taxable income plus business interest income (30% limit under the 2017 Tax Act) for 2019 and 2020. The CARES Act allows taxpayers with alternative minimum tax credits to claim a refund in 2020 for the entire amount of the credits instead of recovering the credits through refunds over a period of years, as originally enacted by the 2017 Tax Act.

In addition, the CARES Act raises the corporate charitable deduction limit to 25% of taxable income and makes qualified improvement property generally eligible for 15-year cost-recovery and 100% bonus depreciation. The enactment of the CARES Act did not result in any material adjustments to our income tax provision.

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 September 30, 2020 and 2019, because the Company incurred net losses and basic and diluted losses per common share are the same. The following common stock equivalents were excluded from the computation of diluted net loss per share of common stock because they were anti-dilutive. The exercise of these common stock equivalents would dilute earnings per share if the Company becomes profitable in the future.

| | <u>September 30,</u> <u>2020</u> | <u>September 30,</u> <u>2019</u> |
|---|-------------------------------------|-------------------------------------|
| Stock Options | 14,044,826 | 12,463,326 |
| Warrants | 5,690,378 | 3,915,378 |
| Convertible debt | 9,157,100 | 7,350,000 |
| Total common stock equivalents excluded from diluted net loss per share | <u>28,892,304</u> | <u>23,728,704</u> |

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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 September 30, 2020 and December 31, 2019 is maintained at high-quality financial institutions and has not incurred any losses to date.

Customer and Supplier Concentration

For each of the nine months ended September 30, 2020 and 2019, 100% of the Company's revenue related to ten and eight customers respectively. At September 30, 2020 and 2019, 100% of the Company's accounts receivable related to eight and seven customers, respectively.

For each of the nine months ended September 30, 2020 and 2019, 85% and 77% of the Company's purchases related to two suppliers, respectively. At September 30, 2020 and 2019, 67% and 78% of the Company's accounts payable and accrued expenses related to two vendors, respectively. The Company believes there are numerous other suppliers that could be substituted should the supplier become unavailable or non-competitive.

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 Adopted Accounting Standards

Effective January 1, 2020, the Company adopted ASU No. 2018-07, *Compensation — Stock Compensation (Topic 718)*. ASU 2018-07 is intended to reduce cost and complexity and to improve financial reporting for nonemployee share based payments. Prior to the issuance of this guidance, the accounting requirements for nonemployee and employee share-based payment transactions were significantly different. ASU 2018-07 expands the scope of Topic 718, Compensation — Stock Compensation (which only included share-based payments to employees) to include share-based payments issued to nonemployees for goods or services. Consequently, the accounting for share-based payments to nonemployees and employees is substantially aligned. This ASU supersedes Subtopic 505-50, Equity — Equity-Based Payments to Nonemployees. The adoption of ASU 2018-07 did not have a material impact on its condensed consolidated financial statements.

Effective January 1, 2020, the Company adopted ASU No. 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement*. The amendments in ASU 2018-13 modify the disclosure requirements associated with fair value measurements based on the concepts in the Concepts Statement, including the consideration of costs and benefits. The amendments on changes in unrealized gains and losses, the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements, and the narrative description of measurement uncertainty should be applied prospectively for only the most recent interim or annual period presented in the initial fiscal year of adoption. All other amendments should be applied retrospectively to all periods presented upon their effective date. The adoption of ASU 2018-13 did not have a material impact on its condensed consolidated financial statements.

Recently Issued Accounting Standards

In December 2019, the FASB issued authoritative guidance intended to simplify the accounting for income taxes (ASU 2019-12, “Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes”). This guidance eliminates certain exceptions to the general approach to the income tax accounting model and adds new guidance to reduce the complexity in accounting for income taxes. This guidance is effective for annual periods after December 15, 2020, including interim periods within those annual periods (beginning with the quarter ended March 31, 2021 for the Company). The Company is currently evaluating the potential impact of this guidance on its condensed consolidated financial statements.

Management does not believe that any recently issued, but not yet effective accounting pronouncements, when adopted, will have a material effect on the accompanying condensed consolidated financial statements.

Note 3 – Going Concern and Financial Condition

Under ASC 205-40, *Presentation of Financial Statements—Going Concern*, the Company has the responsibility to evaluate whether conditions and/or events raise substantial doubt about its ability to meet its future financial obligations as they become due within one year after the date that the financial statements are issued. As required by ASC 205-40, this evaluation shall initially not take into consideration the potential mitigating effects of plans that have not been fully implemented as of the date the financial statements are issued. Management has assessed the Company’s ability to continue as a going concern in accordance with the requirement of ASC 205-40.

The accompanying condensed consolidated financial statements as of September 30, 2020 have been prepared assuming the Company will continue as a going concern. As reflected in the condensed consolidated financial statements, the Company had an accumulated deficit of \$61.5 million and a negative working capital of \$697,845 at September 30, 2020. Additionally, the Company had a net loss in the amount of \$3.8 million and cash used by operating activities of \$1.5 million for the nine months ended September 30, 2020. These factors raise substantial doubt about the Company’s ability to continue as a going concern for the next twelve months from the issuance of these condensed consolidated financial statements within the Company’s Quarterly Report on Form 10-Q. Although we anticipate continued significant revenues for products in be used in MATS compliance activities, no assurances can be given that the Company can obtain sufficient working capital through these activities and additional financing may be needed to meet its obligations. In April 2020, the Company received loan proceeds in the amount of \$299,300 pursuant to the Paycheck Protection Program under the Cares Act which was enacted on March 27, 2020 as a result of the COVID-19 pandemic. Nevertheless, the Company may need to raise additional equity or debt financing. While the Company believes in its ability to raise additional funds, no assurances can be given that the Company can maintain sufficient working capital through these efforts, or that the continued implementation of its business plan will generate sufficient revenues in the future to sustain ongoing operations.

The accompanying condensed 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

Inventory was comprised of the following at September 30, 2020 and December 31, 2019:

| | September 30, 2020 | December 31, 2019 |
|-----------------|-------------------------------|------------------------------|
| Raw Materials | \$ 136,663 | \$ 223,790 |
| Work in Process | 19,484 | 43,814 |
| Spare Parts | 27,632 | 27,632 |
| Finished goods | 289,781 | 218,262 |
| | <u>\$ 473,560</u> | <u>\$ 513,498</u> |

Note 5 - Property and Equipment, Net

Property and equipment at September 30, 2020 and December 31, 2019 are as follows:

| | <u>September 30, 2020</u> | <u>December 31, 2019</u> |
|---------------------------------|-------------------------------|------------------------------|
| Equipment & installation | \$ 1,965,659 | \$ 1,965,659 |
| Trucking equipment | 895,587 | 922,441 |
| Computer equipment and software | 67,126 | 67,126 |
| Office equipment | 27,155 | 27,155 |
| Total property and equipment | <u>2,955,527</u> | <u>2,982,381</u> |
| Less: accumulated depreciation | (2,845,008) | (2,707,745) |
| Construction in process | 1,807,707 | 1,807,707 |
| Property and equipment, net | <u>\$ 1,918,226</u> | <u>\$ 2,082,343</u> |

The Company uses the straight-line method of depreciation over 2 to 5 years. During the three months ended September 30, 2020 and 2019 depreciation expense was \$37,933, and \$84,918, respectively. During the nine months ended September 30, 2020 and 2019 depreciation expense was \$160,537, and \$247,954, respectively.

Note 6 – Intellectual Property

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.

On April 24, 2017, the Company closed on the acquisition of all patent rights from EERCF including all patents and patents pending, domestic and foreign, relating to the foregoing technology. A total of 42 domestic and foreign patents and patent applications were included in the acquisition. In accordance with the terms of the License Agreement, the patent rights were acquired for the purchase price of (i) \$2,500,000 in cash, and (ii) 925,000 shares of common stock of which 628,998 shares were issued to EERCF and 296,002 were issued to the inventors who had been designated by EERCF. The shares issued were valued at \$518,000 (\$0.56 per share), representing the value as of the closing date.

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License and patent costs capitalized as of September 30, 2020 and December 31, 2019 are as follows:

| | <u>September 30, 2020</u> | <u>December 31, 2019</u> |
|--------------------------------|-------------------------------|------------------------------|
| Patents | \$ 3,068,995 | \$ 3,068,995 |
| Less: Accumulated amortization | (699,049) | (536,533) |
| License, net | <u>\$ 2,369,946</u> | <u>\$ 2,532,462</u> |

Amortization expense for the three months ended September 30, 2020 and 2019 was \$51,150 and \$50,300, respectively. Amortization expense for the nine months ended September 30, 2020 and 2019 was \$162,516 and \$150,900, respectively. Estimated annual amortization for each of the next five years is \$204,600.

Note 7 –Notes Payable

On February 25, 2020, and pursuant to a Business Loan Agreement entered into with a banking institution, the Company's wholly owned subsidiary, MES, Inc. closed on a one-year secured loan in the principal amount of \$200,000 bearing interest at 8.75% per annum. Principal and interest is to be paid in equal monthly installments until the loan is paid in full on February 26, 2021. The note is secured by substantially all of the assets of MES, Inc. During the nine months ended September 30, 2020 the Company repaid \$114,415 of principal and \$7,922 of interest.

On April 14, 2020, the Company received loan proceeds in the amount of \$299,300 from First International Bank & Trust pursuant to the Paycheck Protection Program (the "PPP Loan") under the Coronavirus Aid, Relief and Economic Security Act (the "CARES Act"), which was enacted on March 27, 2020. The loan, which is in the form of a Note dated April 14, 2020, matures on April 14, 2022 and bears interest at a rate of 1.0% per annum, with one interest payment on April 14, 2021 and one principal and interest payment on maturity. The principal and accrued interest under the PPP Loan is forgivable after eight or twenty-four weeks if the Company uses the PPP Loan proceeds for eligible purposes, including payroll, benefits, rent and utilities, and otherwise complies with the PPP requirements. In order to obtain forgiveness of the PPP Loan, the Company must submit a request and provide satisfactory documentation regarding its compliance with applicable requirements.

Note 8 –Convertible Notes Payable

The Company has the following convertible notes payable outstanding as of September 30, 2020 and December 31, 2019:

| | <u>September 30, 2020</u> | <u>December 31, 2019</u> |
|---|-------------------------------|------------------------------|
| Secured convertible promissory notes which mature upon the retirement of the New AC Midwest Secured Debt (see Note 9), bear interest at 10% per annum, are convertible into shares of common stock at \$0.50 per share, and are secured by the assets of the Company. | \$ 990,000 | \$ 990,000 |
| Unsecured convertible promissory notes which mature beginning on June 15, 2023 through October 31, 2023, bear interest at 12% per annum, and are convertible into shares of common stock at \$0.50 per share. | 860,000 | 860,000 |
| Unsecured convertible promissory notes which mature beginning on June 18, 2024 through October 23, 2024, bear interest at 12% per annum, and are convertible into shares of common stock at \$0.50 per share. | <u>2,600,000</u> | <u>2,600,000</u> |
| Total convertible notes payable before discount | 4,450,000 | 4,450,000 |
| Less discounts and debt issuance costs | <u>(423,622)</u> | <u>(508,863)</u> |
| Total convertible notes payable | <u>4,026,378</u> | <u>3,941,137</u> |
| Less current portion | <u>-</u> | <u>(990,000)</u> |
| Convertible notes payable, net of current portion | <u>\$ 4,026,378</u> | <u>\$ 2,951,137</u> |

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As of September 30, 2020, remaining scheduled principal payments due on convertible notes payable are as follows:

| Twelve months ended September 30, | |
|--|---------------------|
| 2021 | \$ - |
| 2022 | 990,000 |
| 2023 | 760,000 |
| 2024 | 1,925,000 |
| 2025 | 775,000 |
| | <u>\$ 4,450,000</u> |

As of September 30, 2020, the remaining future amortization of discounts are as follows:

| Twelve months ended September 30, | | Discounts |
|--|----|------------------|
| 2021 | \$ | 114,040 |
| 2022 | | 114,040 |
| 2023 | | 110,721 |
| 2024 | | 82,912 |
| 2025 | | 1,909 |
| | \$ | <u>423,622</u> |

Note 9 - Related Party

Secured Note Payable

On November 29, 2016, pursuant to a new restated financing agreement entered with AC Midwest Energy, LLC ("AC Midwest") on November 1, 2016, the Company closed on a new secured note with AC Midwest (the "New AC Midwest Secured Note") in the original principal amount of \$9,646,686, which was to mature on December 15, 2018. AC Midwest is wholly-owned by a stockholder of the Company. The New AC Midwest Secured Note is guaranteed by MES, is non-convertible and bears interest at a rate of 15.0% per annum, payable quarterly in arrears on or before the last day of each fiscal quarter. Interest expense for the three months ended September 30, 2020 and 2019 was \$10,215 and \$10,415 respectively. Interest expense for the nine months ended September 30, 2020 and 2019 was \$30,653 and \$30,904 respectively. On February 25, 2019, per Amendment No. 3 to the Amended and Restated Financing Agreement, AC Midwest agreed to waive compliance with a certain financial covenant of the Restated Financing Agreement and strike this covenant in its entirety as of the effective date of the amendment. Also, pursuant to Amendment No. 3, the parties agreed that the maturity date for the remaining principal balance due under the AC Midwest Secured Note would be extended from December 15, 2018 to August 25, 2022. The amendment was accounted for as an extinguishment in accordance with ASC 470-50 with no gain or loss recorded. As of both September 30, 2020 and December 31, 2019, total principal of \$271,686 was outstanding on this note.

Unsecured Note Payable

The Company has the following unsecured note payable - related party outstanding as of September 30, 2020 and December 31, 2019:

| | September 30, 2020 | December 31, 2019 |
|--|-------------------------------|------------------------------|
| Unsecured note payable | \$ 13,154,931 | \$ 13,154,931 |
| Less discounts and debt issuance costs | <u>(3,758,952)</u> | <u>(5,243,033)</u> |
| Total unsecured note payable | <u>9,395,979</u> | <u>7,911,898</u> |
| Less current portion | <u>-</u> | <u>-</u> |
| Unsecured note payable, net of current portion | <u>\$ 9,395,979</u> | <u>\$ 7,911,898</u> |

On November 29, 2016, pursuant to a new restated financing agreement entered with AC Midwest on November 1, 2016, the Company closed on an unsecured note with AC Midwest (the "AC Midwest Subordinated Note") in the principal amount of \$13,000,000, which was to mature on December 15, 2020. On February 25, 2019, the Company entered into an Unsecured Note Financing Agreement (the "Unsecured Note Financing Agreement") with AC Midwest, pursuant to which AC Midwest issued an unsecured note in the principal amount of \$13,154,931 (the "New AC Midwest Unsecured Note"), which represented the outstanding principal and accrued and unpaid interest at closing.

In accordance with ASC 470-60-15-5, since the present value of the cash flows under the new debt instrument was at least ten percent different from the present value of the remaining cash flows under the terms of the original debt instrument, the Company accounted for the amendment to note as a debt extinguishment. Accordingly, the Company wrote off the remaining debt discount on the original debentures of \$1,070,819. Since the amendment was with a related party defined in ASC 470-50-40-2 the Company recorded a Capital contribution of \$3,412,204 on this exchange which is primarily related to the difference in fair value of the note on the date of the exchange. The Company determined that the rate of interest on the AC Midwest Subordinated Note was a below market rate of interest and determined that a discount of \$6,916,687 should be recorded. This discount is based on an applicable market rate for unsecured debt for the Company of 21% and will be amortized as interest expense over the life of the loan. Amortized discount recorded as interest expense for the nine months ended September 30, 2020 and 2019 was \$1,484,082 and \$1,175,349, respectively. As of September 30, 2020, the unamortized balance of the discount was \$3,758,952.

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The New AC Midwest Unsecured Note, which has been issued in exchange for the AC Midwest Subordinated Note which has now been cancelled, will mature on August 25, 2022 (the “Maturity Date”). It bears a zero cash interest rate.

AC Midwest shall be entitled to a profit participation preference equal to 1.0 times the original principal amount (the “Profit Share”). If the original principal amount had been paid in full on or prior to August 25, 2020, AC Midwest would have been entitled to a profit participation preference equal to 0.5 times the original principal amount. The Profit Share is “non-recourse” and shall only be derived from and computed on the basis of, and paid from, Net Litigation Proceeds from claims relating to the Company’s intellectual property (see Note 11), Net Revenue Share and Adjusted Free Cash Flow (as such terms are defined in the Unsecured Note Financing Agreement).

The Profit Share

In connection with the New AC Midwest Unsecured Note the Company shall pay the principal outstanding, as well as the Profit Share, in an amount equal to 60.0% of Net Litigation Proceeds until such time as any litigation funder has been paid in full and, thereafter, in an amount equal to 75.0% of such Net Litigation Proceeds until the Unsecured Note and Profit Share have been paid in full. In addition, and within 30 days following the end of each fiscal quarter, the Company shall pay the principal outstanding and Profit Share in an aggregate amount equal to the Net Revenue Share (which means 60.0% of Net Licensing Revenue (as defined) from licensing the Company’s intellectual property) plus Adjusted Free Cash Flow until the Unsecured Note and Profit Share have been paid in full, provided, however, that such payments shall exclude the first \$3,500,000 of Net Licensing Revenue and Adjusted Free Cash Flow achieved commencing with the fiscal quarter ending March 31, 2019. Any remaining principal balance due on the Unsecured Note shall be due and payable in full on the Maturity Date. The Profit Share, however, if not paid in full on or before the Maturity Date, shall remain subject to Unsecured Note Financing Agreement until full and final payment.

The Company is utilizing the methodology behind the ASC 815, *Derivatives and Hedging* and ASC 480, *Distinguishing Liabilities from Equity* to determine how to account for the profit-sharing portion of the note payable. Although the transaction is not indexed to MEEC’s common stock the profit sharing has the characteristics of a freestanding financial instrument because the profit sharing is not callable by the lender, it will be paid out past the maturity of the Unsecured Note Payable and, the fair value will fluctuate over time based on payment predictions. The Profit Share was determined to have a fair value of \$1,954,383 upon grant. This was calculated with discounted cash flow model, with the following key valuation assumptions: estimated term of eighteen years with \$1 million paid yearly after the first five years, and an annual market interest rate of 21%. The profit share liability will be marked to market every quarter utilizing managements estimates.

The following are the changes in the profit share liabilities during the nine months ended September 30, 2020 and 2019.

| | |
|--|---------------------|
| Profit Share as of January 1, 2020 | \$ 2,328,845 |
| Addition | - |
| Gain on change in fair value of profit share | (140,954) |
| Profit Share as of September 30, 2020 | <u>\$ 2,187,891</u> |
| Profit Share as of January 1, 2019 | \$ - |
| Addition | 1,954,383 |
| Loss on change in fair value of profit share | 255,847 |
| Profit Share as of September 30, 2019 | <u>\$ 2,210,230</u> |

Related Party Transactions

Kaye Cooper Kay & Rosenberg, LLP provides certain legal services to the Company and was paid \$137,500 in 2020 for legal services rendered and disbursement incurred. David M. Kaye, a Director and Secretary of the Company, is a partner of the law firm. At September 30, 2020 and December 31, 2019, \$131,250 and \$43,750, respectively, was owed to the firm for services rendered.

Note 10 - Operating Leases

In 2016, the Company entered into a six-year agreement to lease trailers used in the delivery of its products. Monthly payments currently total \$32,820.

On January 27, 2015, the Company entered into a lease for office space in Lewis Center, Ohio, commencing February 1, 2015 which lease as amended expired in February 2020. The lease provides for the option to extend the lease for up to five additional years. Monthly rent is \$1,575 through February 2020. The Company did not renew this lease.

On July 1, 2015, the Company entered into a five-year lease for warehouse space in Corsicana, Texas. Rent is \$3,750 monthly throughout the term of the lease. The Company is also responsible for the pro rata share of the projected monthly expenses for the property taxes. The current pro rata share is \$882. The lease was extended on June 1, 2019 for five years. The Company recorded a right of use asset and an operating lease liability of \$145,267. This amount represents the difference between the value from the remaining lease and the extended lease.

On September 1, 2019, the Company entered into a one-year lease for office space in Grand Forks, North Dakota. Monthly rent was \$590 a month through August 2020. The lease has not been renewed and has been terminated.

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

For the twelve months ended September 30,

| | | |
|--|----|----------------|
| 2021 | \$ | 438,840 |
| 2022 | | 402,520 |
| 2023 | | 92,040 |
| 2024 | | 22,500 |
| Total | | <u>955,900</u> |
| Less discount | | (54,447) |
| Total lease liabilities | | <u>901,453</u> |
| Less current portion | | (402,918) |
| Operating lease obligation, net of current portion | \$ | <u>498,535</u> |

The weighted average remaining lease term for operating leases is 2.27 years and the weighted average discount rate used in calculating the operating lease asset and liability is 5.0%. For the nine months ended September 30, 2020, payments on lease obligations were \$329,130 and amortization on the right of use assets was \$212,372.

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For the three and nine months ended September 30, 2020, the Company's lease cost consists of the following components, each of which is included in costs and expenses within the Company's consolidated statements of operations:

| | Three Months Ended September 30, 2020 | Nine Months Ended September 30, 2020 |
|---------------------------|--|---|
| Operating lease cost | \$ 92,133 | \$ 289,263 |
| Short-term lease cost (1) | 1,770 | 5,310 |
| Total lease cost | <u>\$ 93,903</u> | <u>\$ 294,573</u> |

(1) Short-term lease costs include any lease with a term of less than 12 months

Note 11 – Commitments and Contingencies

Fixed Price Contract

The Company's multi-year contracts with its commercial customers contain fixed prices for product. These contracts expire between 2020 and 2025 and expose the Company to the potential risks associated with rising material costs during that same period. Revenue reported during interim periods were recorded based on the facts and circumstances at the time and any differences noted when the final revenue is determined is considered to be a change in estimate for the period.

Legal proceedings

On July 17, 2019, the Company initiated patent litigation against certain defendants in the U.S. District Court for the District of Delaware for infringement of United States Patent Nos. 10,343,114 (the "'114 Patent") and 8,168,147 (the "'147 Patent") owned by the Company. These patents relate to the Company's two-part Sorbent Enhancement Additive (SEA[®]) process for mercury removal from coal-fired power plants. Named as defendants in the lawsuit are (i) Vistra Energy Corp., AEP Generation Resources Inc., NRG Energy, Inc., Talen Energy Corporation, and certain of their respective affiliated entities, all of which are owners and/or operators of coal-fired power plants in the United States, and (ii) Arthur J. Gallagher & Co., DTE REF Holdings, LLC, CERT Coal Holdings LLC, Chem-Mod LLC, and certain of their respective affiliated entities, and additional named and unnamed defendants, all of which operate or are involved in operations of coal facilities in the United States. In the lawsuit, the Company alleges that each of the defendants has willfully infringed the Company's '114 Patent and '147 Patent and seeks a permanent injunction from further acts of infringement and monetary damages. Such litigation is currently pending and in its early stages.

On April 21, 2020, NRG Energy, Inc., Talen Energy Corporation and Vistra Energy Corp., three of the defendants in the above action, filed two petitions for Inter Partes Review ("IPR") with the United States Patent and Trademark Office ("USPTO"), seeking to invalidate certain claims to the '114 Patent on May 27, 2020, such defendants filed two additional petitions for IPR with the USPTO, seeking to invalidate certain claims to the '147 Patent. On or about July 15, 2020, AEP Generation Resources, Inc., another defendant in the above action, filed four petitions for IPR with the USPTO, seeking to invalidate certain claims to the '114 Patent and '147 Patent. The Company believes that all of the foregoing claims of invalidity are without merit.

On July 30, 2020, the Company and Vistra Corp. executed a multi-year fleetwide license and supply agreement to provide Vistra a non-exclusive license to certain Company patents for use in connection with Vistra's coal-fired power plants, and to facilitate the parties' ongoing business relationship. Such patents licensed to Vistra relate to the Company's two-part Sorbent Enhancement Additive (SEA[®]) process for mercury removal from coal-fired power plants. The Company has dismissed all claims brought against Vistra in the patent litigation initiated by the Company and Vistra has agreed to withdraw from petitions for IPR filed with the USPTO.

On October 26, 2020, and with respect to the two IPRs filed on April 21, 2020, the Board determined that the petitioners demonstrated a reasonable likelihood of prevailing with respect to at least one claim of the '114 Patent and, accordingly, instituted such IPRs.

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On November 9, 2020, the Company entered into an agreement with another defendant to provide such defendant and its affiliated entities a non-exclusive license to certain Company patents (related to the Company's two-part Sorbent Enhancement Additive (SEA[®]) process) for use in connection with such parties' coal-fired power plants. The Company has agreed to dismiss all claims brought against such defendant and its affiliated entities in the above referenced patent litigation and such defendant has agreed to withdraw from petitions for IPR filed with the USPTO.

The above described proceedings will continue with respect to the other parties involved.

Except for the foregoing disclosures, the Company is not presently aware of any other material pending legal proceedings to which the Company is a party or of which any of its property is the subject.

Litigation, including patent litigation, is inherently subject to uncertainties. As such, there can be no assurance that the Company will be successful in litigating and/or settling any of these claims.

Note 12 - Stock Based Compensation

Stock Based Compensation

Stock based compensation consists of the amortization of common stock, stock options and warrants issued for prepaid services. For the three months ended September 30, 2020 and 2019, stock based compensation amounted to \$369,427 and \$0, respectively. For the nine months ended September 30, 2020 and 2019, stock based compensation amounted to \$619,176 and \$1,762,736, respectively. Such expense is classified in selling, general and administrative expenses.

Common Stock

As of January 1, 2020, and pursuant to an advisory agreement dated as of November 20, 2019 and effective as of January 1, 2020 for a term of one year with a nonaffiliated third party, the Company issued 1,000,000 shares of common stock of the Company to such third party as and for the entire compensation to be paid for all services to be rendered during the term. These shares of common stock were valued at \$200,000 in accordance with FASB ASC Topic 718. The fair value of the shares is being amortized to selling, general and administrative expenses within the Company's condensed consolidated statements of operations over one year.

Stock Options

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 condensed consolidated financial statements over the vesting period based on the estimated fair value of the awards.

A summary of stock option activity for the nine months ended September 30, 2020 is presented below:

| | <u>Number of Shares</u> | <u>Weighted Average Exercise Price</u> | <u>Weighted Average Remaining Contractual Life (years)</u> | <u>Aggregate Intrinsic Value</u> |
|-------------------------|-----------------------------|--|--|--|
| January 1, 2020 | 12,553,326 | \$ 0.55 | 4.02 | \$ 927 |
| Grants | 2,250,000 | 0.19 | 4.77 | |
| Expirations | <u>(758,500)</u> | 0.68 | - | |
| September 30, 2020 | 14,044,826 | \$ 0.48 | 3.60 | \$ 843,586 |
| Options exercisable at: | | | | |
| September 30, 2020 | 13,919,826 | \$ 0.49 | 3.59 | \$ 823,586 |

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The aggregate intrinsic value in the table above represents the total intrinsic value, based on the Company's closing stock price of \$0.35 as of September 30, 2020, which would have been received by the option holders had all option holders exercised their options as of that date.

The Company utilized the Black-Scholes options pricing model to value its options granted. The assumptions used for options granted during the nine months ended September 30, 2020 and 2019 are as follows:

| | September 30, 2020 | September 30, 2019 |
|-------------------------|-----------------------|-----------------------|
| Exercise price | \$ 0.19 | \$ 0.27 |
| Expected dividends | 0% | 0% |
| Expected volatility | 103-84% | 100% |
| Risk free interest rate | 0.33–0.30% | 3% |
| Expected life | 5–4.12 years | 5 years |

On June 15, 2020, the Company granted nonqualified stock options to acquire an aggregate of 250,000 shares of the Company's common stock under the Company's 2017 Equity Incentive Plan (the "2017 Plan") to an employee. The options granted are exercisable at \$0.19 per share, representing the fair market value of the common stock on the date of grant as determined under the 2017 Plan. Fifty percent of the options are fully vested and exercisable as of the date of grant and fifty percent of the options vest on April 1, 2021. The options will expire five years from the date of grant. Based on a Black-Scholes valuation model, these options were valued at \$37,882 in accordance with FASB ASC Topic 718 which will be expensed over the vesting period in selling, general and administrative expenses within the Company's consolidated statements of operations.

On July 8, 2020, the Board of Directors of the Company approved an amendment to the 2017 Plan to increase the maximum number of shares of common stock that may be issued under the 2017 Plan from 8,000,000 to 12,000,000 shares. On the same date, the Company granted nonqualified stock options to the following executive officers to each acquire 500,000 shares of the Company's common stock: Richard MacPherson (President and Chief Executive Officer), John Pavlish (Senior Vice President and Chief Technology Officer) and James Trettel (Vice President of Operations); and, also granted nonqualified stock options to the following persons to each acquire 250,000 shares of the Company's common stock: Christopher Greenberg (Chairman of the Board) and David M. Kaye (director). All of such options were granted under the 2017 Plan and are exercisable at \$0.19 per share, representing the fair market value of the common stock on the date of grant as determined under the 2017 Plan. The options are fully vested and exercisable as of the date of grant and will expire five years thereafter. Based on a Black-Scholes valuation model, these options were valued at \$246,965 in accordance with FASB ASC Topic 718 which was expensed on the grant date in selling, general and administrative expenses within the Company's consolidated statements of operations.

Note 13 - Warrants

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 100%, a risk-free interest rate and the life of the warrant for the exercise period.

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The following is a summary of the Company's warrant activity:

| | Number of Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Life (years) | Aggregate Intrinsic Value |
|--------------------------|---------------------|--|---|---------------------------------|
| January 1, 2020 | 5,690,378 | \$ 0.63 | 3.72 | \$ - |
| Grants | - | - | - | - |
| Expirations | - | - | - | - |
| September 30, 2020 | 5,690,378 | \$ 0.63 | 2.97 | \$ - |
| Warrants exercisable at: | | | | |
| September 30, 2020 | 5,690,378 | \$ 0.63 | 2.97 | \$ - |

The aggregate intrinsic value in the table above represents the total intrinsic value, based on the Company's closing stock price of \$0.35 as of September 30, 2020, which would have been received by the option holders had all option holders exercised their options as of that date.

The following table summarizes information about common stock warrants outstanding at September 30, 2020:

| Outstanding and Exercisable | | | | | |
|-----------------------------|-----------------------|---|--|--|--|
| Exercise Price | Number Outstanding | Weighted Average Remaining Contractual Life (years) | Weighted Average Exercise Price | | |
| \$ 0.70 | 4,460,000 | 3.70 | \$ 0.70 | | |
| 0.45 | 150,000 | 0.17 | 0.45 | | |
| 0.35 | 1,080,378 * | 0.38 | 0.35 | | |
| \$ 0.35-\$0.70 | 5,690,378 | 2.97 | \$ 0.63 | | |

* 205,000 warrants exercisable at \$0.35 contain dilution protections that increase the number of shares purchasable at exercise upon the issuance of securities at a price below the current exercise price.

Note 14 – Subsequent Events

On October 1, 2020, the Company extended the expiration date of a previously issued warrant to acquire 150,000 shares of common stock of the Company at an exercise price of \$0.45 per share. Such warrant was issued to a nonaffiliated third-party providing investor relations consulting services to the Company. The warrant will now expire November 30, 2023.

On October 5, 2020, the Company issued 300,000 shares of common stock of the Company to a nonaffiliated third-party pursuant to a consulting agreement entered into on October 1, 2020.

See Note 11 for information on the agreement entered into on November 9, 2020 by the Company with one of the defendants in the patent litigation commenced in 2019 which agreement will provide such defendant and its affiliated entities a non-exclusive license to certain Company patents (related to the Company's two-part Sorbent Enhancement Additive (SEA[®]) process) for use in connection with such parties' coal-fired power plants.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion should be read in conjunction with the unaudited condensed consolidated financial statements and the related notes that appear elsewhere within this report. Certain statements we make under this Item 2 constitute “forward-looking statements” under the Private Securities Litigation Reform Act of 1995. See “Forward-Looking Statements” in “Part I” preceding “Item 1 – Financial Information.” You should consider our forward-looking statements in light of the risks discussed under the heading “Risk Factors” in Item 1A of Part I of our Annual Report on Form 10-K for the year ended December 31, 2019, as well as our unaudited condensed consolidated financial statements, related notes and other financial information appearing elsewhere in this report and our other filings with the Securities and Exchange Commission.

Background

Midwest Energy Emissions Corp. (the “Company”, “we”, “us” and “our”) is an environmental services and technology company specializing in mercury emission control technologies, primarily to utility and industrial coal-fired units. We deliver patented and proprietary solutions to the global coal-power industry to remove mercury from power plant emissions, providing performance guarantees, and leading-edge emissions services. We have developed patented technology and proprietary products that have been shown to achieve mercury removal at a significantly lower cost and with less operational impact than currently used methods, while maintaining and/or increasing unit output and preserving the marketability of fly-ash for beneficial use.

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

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

The MATS regulation has been subject to legal challenge, and in June 2015, the U.S. Supreme Court held that the EPA unreasonably failed to consider costs in determining whether it is “appropriate and necessary” to regulate hazardous air pollutants, including mercury, from power plants. The Court remanded the case back to the U.S. Court of Appeals for the District of Columbia Circuit for further proceedings, but left the rule in place. In December 2015, the D.C. Circuit remanded the rule back to the EPA for further consideration while allowing MATS to remain in effect pending the EPA’s finding; the Supreme Court later denied a petition challenging the lower court’s decision to remand without vacating. On April 14, 2016, EPA issued a final supplemental finding reaffirming the MATS rule on the ground that it is supported by the cost analysis the Supreme Court required. That supplemental finding is under review by the D.C. Circuit, and the Company is unable to predict with certainty the outcome of these proceedings. On April 18, 2017, EPA asked the court to place that litigation in abeyance, stating that the Agency is reviewing the supplemental finding to determine whether it should be reconsidered in whole or in part. The court granted EPA’s abeyance request on April 27, 2017, and ordered EPA to file 90-day status reports starting July 26, 2017. In February 2019, the EPA published a proposed revised supplemental cost-benefits finding for MATS in which EPA proposed to conclude that the 2016 supplemental finding was flawed in part due to its reliance on co-benefits to justify MATS. Nevertheless, the EPA proposed to leave the MATS rule in place. At the same time, EPA also requested public comment on whether MATS may or must be rescinded if EPA reversed its earlier conclusion that it is “appropriate and necessary” to regulate power plant emissions of mercury and other hazardous air pollutants under the statutory provision authorizing MATS. Following the close of the public comment period, on April 16, 2020, the EPA issued a final rule which finalized the proposed supplemental cost-benefits finding in substantially the form proposed in 2019. The final rule withdraws EPA’s 2016 “appropriate-and-necessary” determination as erroneous, but leaves the 2011 MATS rule in place pursuant to D.C. Circuit case law holding that a source category may only be removed from the list of categories to be regulated through a rigorous delisting process that cannot currently be satisfied by EPA. EPA’s final action will almost certainly be challenged in the courts, some of which has already begun, both by those who favor retention of MATS (such as the electric utility industry) and by those who oppose it (such as certain coal interests and deregulatory groups). This litigation could extend uncertainty over the status of MATS for a number of years. Investors should note that any changes to the MATS rule could have a negative impact on our business.

Executive Overview

We remain focused on positioning the Company for short and long-term growth. During 2018, we focused on execution at our customer sites and on continual operation improvement. We continue to make refinements to all of our key products, as we continue to focus on the customer and its operations. As part of our overall strategy, we have a number of initiatives which we believe will be able to drive our short and long-term growth.

Our acquisition of all the patent rights, including all patents and patents pending, domestic and foreign, which forms the basis of our mercury control technology, which acquisition was completed in April 2017 provides a strong foundation for us to seek new customers for product using a two-part mercury control process or to offer licenses on a case by case basis.

In the United States, we continue to seek new utility customers for our technology in order for them to meet the MATS requirements as well as maintaining our contractual arrangements with our current customers. In Europe, we had been working to penetrate this market through our licensing agreement entered into in March 2018 with one of our primary suppliers. Such arrangement has been terminated effective as of December 6, 2020. We intend to continue to pursue the European market when certain new regulations are expected to take effect in 2021 and 2022, although no assurance can be made that any such efforts will be successful.

On February 25, 2019, we were able to complete the restructuring of our unsecured and secured debt obligations held by AC Midwest Energy LLC extending the maturity dates of these debts until 2022 and eliminating quarterly principal payment requirements. This restructuring reflects the commitment of our financial partner in our efforts to attract new business, manage our present customers and monetize our patent portfolio.

From June through October 2019, we raised \$2,600,000 in a private placement offering of 12.0% unsecured convertible promissory notes and warrants sold and issued to certain accredited investors.

In July 2019, we announced that we had initiated patent litigation against defendants in the U.S. District Court for the District of Delaware for infringement of certain patents which relate to our two-part Sorbent Enhancement Additive (SEA[®]) process for mercury removal from coal-fired power plants.

In October 2019, we entered into a license and development agreement with an unaffiliated entity located in Alabama pursuant to which the parties will work together to develop a plan to commercialize and market certain technology owned by such unaffiliated entity related to the removal of mercury from air and water emissions generated by coal burning power plants.

On July 30, 2020, we executed a multi-year fleetwide license and supply agreement with Vistra Corp. (“Vistra”), one of the defendants in the patent litigation commenced in 2019, to provide Vistra a non-exclusive license to certain of our patents for use in connection with Vistra’s coal-fired power plants, and to facilitate the parties’ ongoing business relationship. Such patents licensed to Vistra relate to our two-part Sorbent Enhancement Additive (SEA[®]) process for mercury removal from coal-fired power plants. Pursuant thereto, Vistra has agreed to purchase from the Company a certain amount of product or services or pay us a certain amount quarterly over a four-year period.

On November 9, 2020, we entered into an agreement with another defendant in the patent litigation to provide such defendant and its affiliated entities a non-exclusive license to the Company’s patents (as referenced in the preceding paragraph) for use in connection with such parties’ coal-fired power plants.

Although we face a host of challenges and risks, we are optimistic about our future and expect our business to grow substantially.

It should be noted that our operations may be affected by the recent and ongoing outbreak of the coronavirus disease (COVID-19) which was declared a pandemic by the World Health Organization in March 2020. The ultimate disruption which may be caused by the outbreak is uncertain; however, it may result in a material adverse impact on our financial position, operations and cash flow. Such disruptions may include, but are not limited to, the availability of raw materials and equipment, and disruptions to our workforce or to our business relationships with other third parties.

Results of Operations**Revenues**

We generated revenues of approximately \$2,812,000 and \$3,596,000 for the three months ended September 30, 2020 and 2019, respectively and approximately \$5,812,000 and \$8,893,000 for the nine months ended September 30, 2020 and 2019, respectively. Such revenues were primarily derived from sorbent product sales which were approximately \$2,781,000 and \$3,505,000 for the three months ended September 30, 2020 and 2019, respectively and approximately \$5,687,000 and \$8,582,000 for the nine months ended September 30, 2020 and 2019, respectively. The decrease from the prior year period is primarily due to decreased generation in the coal fired power sector principally due to renewables and low natural gas prices.

Equipment sales and other revenues for the three months ended September 30, 2020 and 2019 were approximately \$31,600 and \$91,100, respectively and approximately \$125,100 and \$310,700 for the nine months ended September 30, 2020 and 2019, respectively. This decrease was primarily due to decreased demonstration revenues in the first nine months of 2020 compared to the same period last year.

Costs and Expenses

Total costs and expenses were approximately \$3,937,000 and \$4,400,000 during the three months ended September 30, 2020 and 2019, respectively. The decrease in costs and expenses for the three months ended September 30, 2020 is primarily attributable to the decrease in cost of sales principally due to the decrease in sales, as well as a decrease in the loss on change in fair value of profit share. This was partially offset by increases in selling, general and administrative expense and interest expense. Total costs and expenses were approximately \$9,615,000 and \$13,502,000 during the nine months ended September 30, 2020 and 2019, respectively. The decrease in costs and expenses for the nine months ended September 30, 2020 is primarily attributable to the decrease in cost of sales principally due to the decrease in sales, as well as a decrease in selling, general and administrative expenses and a gain on change in fair value of profit share. This was partially offset by increases in interest expense.

Cost of sales were approximately \$1,882,000 and \$2,478,000 for the three months ended September 30, 2020 and 2019, respectively and approximately \$4,198,000 and \$6,439,000 for the nine months ended September 30, 2020 and 2019, respectively. This year to date the decrease in cost of sales is primarily attributable to decreased sales.

Selling, general and administrative expenses were approximately \$1,271,000 and \$1,186,000 for the three months ended September 30, 2020 and 2019, respectively. The increase in selling, general and administrative expenses for the three months ended September 30, 2020 is primarily attributed to an increase in stock-based compensation compared to the comparable period of 2019. Selling, general and administrative expenses were approximately \$3,577,000 and \$5,116,000 for the nine months ended September 30, 2020 and 2019, respectively. The decrease in selling, general and administrative expenses for the nine months ended September 30, 2020 is primarily attributed to a decrease in stock-based compensation compared to the comparable period of 2019.

Interest expense related to the financing of capital was approximately \$672,000 and \$623,000 for the three months ended September 30, 2020 and 2019, respectively and approximately \$1,987,000 and \$1,691,000 for the nine months ended September 30, 2020 and 2019, respectively. The year to date increase in 2020 is due to the incentives provided with the notes issued in 2019, offset by the reduced interest on the notes payable. The breakdown of interest expense for the three and nine months ended September 2020 and 2019 is as follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---------------|--|-----------------|
| | 2020 | 2019 | 2020 | 2019 |
| | (In thousands) | | (In thousands) | |
| Interest expense on notes payable | \$ 144 | \$ 105 | \$ 417 | \$ 390 |
| Amortization of discount of notes payable | 497 | 488 | 1478 | 1201 |
| Amortization of debt issuance costs | 31 | 30 | 92 | 100 |
| | <u>\$ 672</u> | <u>\$ 623</u> | <u>\$ 1,987</u> | <u>\$ 1,691</u> |

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(Gain) loss on change in fair value of profit share liability (relating to the restructured unsecured debt obligation held by AC Midwest Energy LLC) were approximately \$111,000 and \$113,000 for the three months ended September 30, 2020 and 2019, respectively and approximately \$(141,000) and \$256,000 for the nine months ended September 30, 2020 and 2019, respectively. The change is primarily attributed to a decrease in the fair value of the profit share liability.

Net Income (Loss)

For the three months ended September 30, 2020 and 2019, we had a net loss of approximately \$1,125,000 and \$804,000, respectively. Such increase was primarily due to a decrease in revenues for the three-month period.

For the nine months ended September 30, 2020 and 2019, we had a net loss of approximately \$3,803,000 and \$4,609,000, respectively. Although revenues decreased for the nine months ended September 30, 2020 compared to the nine months ended September 30, 2019, the net loss for the nine months ended September 30, 2020 compared to the prior year period decreased by approximately \$806,000 primarily due to the substantial decrease in total costs and expenses principally due to the decrease in stock based compensation allocated in selling, general and administrative expenses and the gain recognized during the nine months ended September 30, 2020 from the on change in fair value of profit share.

Liquidity and Capital Resources

We had approximately \$319,000 in cash on our balance sheet at September 30, 2020 compared to approximately \$1,499,000 at December 31, 2019. Total current assets were approximately \$2,453,000 and total current liabilities were approximately \$3,151,000 at September 30, 2020, resulting in a working capital deficit of approximately \$698,000. This compares to total current assets of approximately \$3,552,000 and total current liabilities of approximately \$3,854,000 at December 31, 2019, resulting in a working capital deficit of approximately \$302,000. Our accumulated deficit was approximately \$61.5 million at September 30, 2020 compared to \$57.7 million at December 31, 2019. Additionally, we had a net loss in the amount of approximately \$3,803,000 and cash used in operating activities of approximately \$1,538,000 for the nine months ended September 30, 2020.

During 2018, we restructured convertible notes totaling \$560,000 into new loans that mature in 2023. In February 2019, we completed the restructuring of our unsecured and secured debt obligations held by a principal shareholder, extending the maturity dates of these debts and the remaining convertible notes until 2022 and eliminating quarterly principal payment requirements. From June through October 2019, we sold \$2,600,000 new convertible notes which mature in 2024 to investors. Nevertheless, the accompanying condensed consolidated financial statements as of September 30, 2020 have been prepared assuming we will continue as a going concern. As reflected in the condensed consolidated financial statements included with this report, we had an accumulated deficit of approximately \$61.5 million and a negative working capital of approximately \$696,000 at September 30, 2020. Additionally, we had a net loss in the amount of approximately \$3.8 million and cash used in operating activities of \$1.5 million for the nine months ended September 30, 2020. These factors raise substantial doubt about our ability to continue as a going concern for the next twelve months from the issuance of this Quarterly Report on Form 10-Q. Although we anticipate continued significant revenues for products to be used in MATS compliance activities, no assurances can be given that we can obtain sufficient working capital through these activities and additional financing may be needed to meet its obligations. In February 2020, we closed on a one-year secured loan with a bank in the principal amount of \$200,000, and in April 2020, we received loan proceeds in the amount of \$299,300 (the "PPP Loan") pursuant to the Paycheck Protection Program under the CARES Act which was enacted on March 27, 2020 as a result of the COVID-19 pandemic. The principal and accrued interest under the PPP Loan is forgivable if we use the PPP Loan proceeds for eligible purposes during an 8 or 24 week period from the date of the loan, including payroll, benefits, rent and utilities, and we otherwise comply with the PPP requirements. In order to obtain forgiveness of the PPP Loan, we must submit a request and provide satisfactory documentation regarding our compliance with applicable requirements. Notwithstanding the foregoing loans, we may need to raise additional equity or debt financing. While we believe in our ability to raise additional funds, no assurances can be given that we can maintain sufficient working capital through these efforts, or that the continued implementation of our business plan will generate sufficient revenues in the future to sustain ongoing operations.

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Total assets were approximately \$7,635,000 at September 30, 2020 versus approximately \$9,273,000 at December 31, 2019. The change in total assets is primarily attributable to decreases in cash and prepaid expenses and other assets.

Total liabilities were approximately \$19,839,000 at September 30, 2020 versus approximately \$18,147,000 at December 31, 2019. The increase in liabilities is primarily due to an increase in notes payable and convertible notes payable offset by a decrease in accounts payable and accrued expenses.

Net cash used in operating activities consists of net loss, adjusted by certain non-cash items, and changes in operating assets and liabilities.

Net cash used in operating activities was approximately \$1,538,000 for the nine months ended September 30, 2020 compared to net cash used in operating activities of approximately \$1,305,000 for the nine months ended September 30, 2019. The increase in cash used in operating activities of approximately \$233,000 was primarily due to an approximate \$652,000 increase in net loss after adjusting for non-cash items from period to period, offset by a change in operating assets and liabilities of approximately \$420,000 primarily attributable to an increase in accounts payable and accrued liabilities plus a decrease in inventory, offset by a decreases in operating lease liability.

Net cash provided by investing activities was \$9,500 for the nine months ended September 30, 2020 compared to net cash provided by investing activities of \$0 for the nine months ended September 30, 2019. The increase is attributed to the cash received from the sale of equipment.

Net cash provided by financing activities was approximately \$348,000 for the nine months ended September 30, 2020 compared to net cash provided by financing activities of approximately \$1,719,000 for the nine months ended September 30, 2019. During the nine months ended September 30, 2020, we received \$499,000 from the issuance of notes payable while during the nine months ended September 30, 2019, we received \$1,825,000 from the issuance of convertible promissory notes and warrants.

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

For detailed information regarding our critical accounting policies and estimates, see our financial statements and notes thereto included in this Report and in our Annual Report on Form 10-K for the year ended December 31, 2019. There have been no material changes to our critical accounting policies and estimates from those disclosed in our most recent Annual Report on Form 10-K.

Non-GAAP Financial Measures

Adjusted EBITDA

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

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

The following table shows our reconciliation of Net loss to adjusted EBITDA for the three and nine months ended September 30, 2020 and 2019, respectively:

| | <u>For the Three Months Ended</u> | | <u>For the Nine Months Ended</u> | |
|------------------------------------|-----------------------------------|----------------------|----------------------------------|----------------------|
| | <u>September 30,</u> | <u>September 30,</u> | <u>September 30,</u> | <u>September 30,</u> |
| | <u>2020</u> | <u>2019</u> | <u>2020</u> | <u>2019</u> |
| | (In thousands) | | (In thousands) | |
| Net loss | \$ (1,125) | \$ (804) | \$ (3,803) | \$ (4,609) |
| Non-GAAP adjustments: | | | | |
| Depreciation and amortization | 108 | 230 | 535 | 717 |
| Interest and letter of credit fees | 672 | 623 | 1,987 | 1,691 |
| Income taxes | - | - | - | - |
| Stock based compensation | 369 | - | 619 | 1,763 |
| Adjusted EBITDA | <u>\$ 24</u> | <u>\$ 49</u> | <u>\$ (662)</u> | <u>\$ (438)</u> |

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.

Evaluation of Disclosure Controls and Procedures

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

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

Changes in Internal Control over Financial Reporting

Except as discussed below, there have been no changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15 (f) under the Exchange Act) during the fiscal quarter covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting except the updated business processes and internal controls made in support of the adoption of the new lease accounting standard.

Certain actions have been taken to address certain aspects of the material weaknesses disclosed above. As of January 1, 2020, we replaced our previous accounting software with a more efficient software package to manage our business activities and accounting needs. Although we no longer have a full-time CFO, during the fourth quarter of 2019 we hired a new full-time Controller at our Corsicana, Texas location, closed our Lewis Center, Ohio office and moved our corporate headquarters to our Corsicana, Texas address which has allowed us to consolidate our manufacturing and distribution activities, bookkeeping and accounting at one location. As of October 21, 2020, our Controller was appointed and promoted to Chief Accounting Officer and Principal Accounting Officer of the Company. Also, in the fourth quarter of 2019, we hired a financial consulting firm to assist us in bookkeeping and preparing financial statements for our SEC filings, assist us in evaluating our internal controls over financial reporting and assist us in other related matters. We continue to actively plan for and implement additional control procedures to improve our overall control environment and expect these efforts to continue throughout 2020 and beyond. Due to the nature of the remediation process, the need to have sufficient resources (cash or otherwise) to devote to such efforts, and the need to allow adequate time after implementation to evaluate and test the effectiveness of the controls, no assurance can be given as to the timing of achievement of remediation.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings.

Reference is hereby made to the Annual Report on Form 10-K for the year ended December 31, 2019 for information on patent litigation initiated by us on July 17, 2019 against certain defendants in the U.S. District Court for the District of Delaware for infringement of United States Patent Nos. 10,343,114 (the “‘114 Patent”) and 8,168,147 (the “‘147 Patent”) owned by the Company. In the lawsuit, the Company alleges that each of the defendants has willfully infringed the Company’s ‘114 Patent and ‘147 Patent and seeks a permanent injunction from further acts of infringement and monetary damages. Such litigation is currently pending and in its early stages.

On April 21, 2020, NRG Energy, Inc., Talen Energy Corporation and Vistra Energy Corp., three of the defendants in the above action, filed two petitions for Inter Partes Review (“IPR”) with the United States Patent and Trademark Office (“USPTO”), seeking to invalidate certain claims to the ‘114 Patent. On May 27, 2020, such defendants filed two additional petitions for IPR with the USPTO, seeking to invalidate certain claims to the ‘147 Patent. On or about July 15, 2020, AEP Generation Resources, Inc., another defendant in the above action, filed four petitions for IPR with the USPTO, seeking to invalidate certain claims to the ‘114 Patent and ‘147 Patent.

An IPR is a trial proceeding for challenging the validity of a US patent before the Patent and Trial and Appeal Board (the “Board”) of the USPTO. To institute an IPR, the Board must determine that the information presented in the petition shows there is a reasonable likelihood that the petitioner would prevail with respect to at least one of the claims challenged in the petition. If the proceeding is instituted and not dismissed, a final determination by the Board will be issued within one year which may be extended for good cause.

On July 30, 2020, the Company and Vistra Corp. executed a multi-year fleetwide license and supply agreement to provide Vistra a non-exclusive license to certain Company patents for use in connection with Vistra’s coal-fired power plants, and to facilitate the parties’ ongoing business relationship. Such patents licensed to Vistra relate to the Company’s two-part Sorbent Enhancement Additive (SEA[®]) process for mercury removal from coal-fired power plants. The Company has dismissed all claims brought against Vistra in the above referenced patent litigation and Vistra has agreed to withdraw from petitions for IPR filed with the USPTO.

On October 26, 2020, and with respect to the two IPRs filed on April 21, 2020, the Board determined that the petitioners demonstrated a reasonable likelihood of prevailing with respect to at least one claim of the ‘114 Patent and, accordingly, instituted such IPRs.

On November 9, 2020, the Company entered into an agreement with another defendant to provide such defendant and its affiliated entities a non-exclusive license to certain Company patents (related to the Company’s two-part Sorbent Enhancement Additive (SEA[®]) process) for use in connection with such parties’ coal-fired power plants. The Company has agreed to dismiss all claims brought against such defendant and its affiliated entities in the above referenced patent litigation and such defendant has agreed to withdraw from petitions for IPR filed with the USPTO.

The above described proceedings will continue with respect to the other parties involved.

Other than the foregoing, there are no material pending legal proceedings to which we are a party or to which any of our property is subject, nor are there any such proceedings known to be contemplated by governmental authorities.

Item 1A. Risk Factors.

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

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

None.

Item 3. Default Upon Senior Securities.

Not applicable.

Item 4. Mine Safety Disclosures.

Not applicable.

Item 5. Other Information.

None.

Item 6. Exhibits.

| Exhibit Number | Description |
|---------------------------|--|
| 31.1* | Certification by Principal Executive Officer and Principal Financial Officer, required by Rule 13a-14(a) or Rule 15d-14(a) of the Exchange Act |
| 32.1* | Certification by Principal Executive Officer and Principal 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 September 30, 2020 formatted in Extensible Business Reporting Language (XBRL): (i) the Condensed Consolidated Unaudited Balance Sheets, (ii) the Condensed Consolidated Unaudited Statements of Operations, (iii) the Condensed Consolidated Unaudited Statements of Stockholders' Deficit, (iv) the Condensed Consolidated Unaudited Statements of Cash Flows, and (v) Notes to Condensed Consolidated Unaudited Financial Statements |

* Filed herewith.

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: November 23, 2020

By: /s/ Richard MacPherson

Richard MacPherson
President and Chief Executive Officer
(Principal Executive Officer and
Principal Financial Officer)

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 officer(s) 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 subsidiary, 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: November 23, 2020

By: /s/ Richard MacPherson

Richard MacPherson,
President and Chief Executive Officer
(Principal Executive Officer and
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 September 30, 2020, 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: November 23, 2020

By: /s/ Richard MacPherson

Richard MacPherson,
President and Chief Executive Officer
(Principal Executive Officer and
Principal Financial Officer)