

ENVIRONMENTAL POWER CORP

Form S-1/A

April 30, 2009

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As filed with the Securities and Exchange Commission on April 30, 2009

Registration Statement No. 333-158286

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

AMENDMENT NO. 1

TO

FORM S-1

REGISTRATION STATEMENT

UNDER

THE SECURITIES ACT OF 1933

ENVIRONMENTAL POWER CORPORATION

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

1311
(Primary Standard Industrial
Classification Code Number)
120 White Plains Road, 6th Floor

75-3117389
(I.R.S. Employer Identification No.)

Tarrytown, New York 10591

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(914) 631-1435

(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

Richard E. Kessel

President and Chief Executive Officer

Environmental Power Corporation

120 White Plains Road, 6th Floor

Tarrytown, New York 10591

(914) 631-1435

(Name, address, including zip code, and telephone number, including area code, of agent for service)

With copies to:

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Vice President and General Counsel

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Approximate date of commencement of proposed sale to public: As soon as practicable after this Registration Statement becomes effective.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box. "

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. "

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If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. "

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. "

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

Large accelerated filer " Accelerated filer
 Non-accelerated filer " Smaller reporting company

(Do not check if a smaller reporting company)

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to be Registered	Amount to Be Registered	Proposed Maximum Aggregate Offering Price	Amount of Registration Fee
14% Convertible Notes due January 1, 2014	\$5,000,000(1)	\$5,000,000(1)	\$279(2)
Common stock(2)	(2)	n/a	n/a

- (1) Estimated solely for the purpose of calculating the registration fee pursuant to Rule 457(o) of the Securities Act of 1933, as amended.
- (2) Previously paid.
- (3) This registration statement also registers up to 925,926 shares of the registrant's common stock, \$0.01 par value per share, as may be issued from time to time upon conversion of the debt securities registered hereunder, which shares are not subject to an additional fee pursuant to Rule 457(i) of the Securities Act.

The Company hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Company shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the Registration Statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), shall determine.

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The information in this prospectus is not complete and may be changed. A registration statement relating to these securities has been filed with the Securities and Exchange Commission. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

SUBJECT TO COMPLETION, DATED APRIL 30, 2009

Prospectus

Energy that is Beyond Renewable®

\$5,000,000

14% Convertible Notes due January 1, 2014

We are offering our 14% Convertible Notes due January 1, 2014, referred to as the notes, in the aggregate original principal amount of \$5,000,000. The notes will bear interest at the rate of 14% per year. Interest will be paid on January 1 and July 1 of each year, commencing on July 1, 2009 (or if such date is not a business day, then on the next business day), subject to limited exceptions if the notes are converted or redeemed prior to an applicable interest payment date.

The notes are not listed for trading on any national securities exchange, and we have no plans to list the notes on any exchange. There is no established trading market for the notes.

Our common stock is quoted on The NASDAQ Capital Market under the symbol EPG. On April 29, 2009, the last reported sale price of our common stock on The NASDAQ Capital Market was \$0.51 per share.

An investment in the notes involves a high degree of risk. Potential investors are advised to read the prospectus in its entirety. Please see the section entitled RISK FACTORS beginning on page 7 of this prospectus to read about risks you should consider carefully before buying our securities.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

	Per Note	Total
Public Offering Price	100%	\$ 5,000,000
Underwriting discount	6%	\$ 300,000
Proceeds, before expenses, to us	94%	\$ 4,700,000

The offering prices set forth above do not include accrued interest, if any. Interest on the notes will accrue from the date of original issuance of the notes.

We estimate the total expenses of this offering, excluding the underwriting discount, will be approximately \$225,000.

The underwriter is expected to deliver the notes in book-entry form only through the facilities of The Depository Trust Company in New York, New York on or about _____, 2009.

ZIEGLER CAPITAL MARKETS

a division of B.C. Ziegler and Company

The date of this prospectus _____, 2009

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ABOUT THIS PROSPECTUS

We are offering to sell, and seeking offers to buy, our notes only in jurisdictions where offers and sales are permitted. The distribution of this prospectus and the offering of the notes in certain jurisdictions may be restricted by law. Persons outside the United States who come into possession of this prospectus must inform themselves about, and observe any restrictions relating to, the offering of the notes and the distribution of this prospectus outside the United States. This prospectus does not constitute, and may not be used in connection with, an offer to sell, or a solicitation of an offer to buy, any securities offered by this prospectus by any person in any jurisdiction in which it is unlawful for such person to make such an offer or solicitation.

You should rely only on the information contained in this prospectus and the documents incorporated by reference in this prospectus or to which we have referred you. We have not, and the underwriter has not, authorized anyone to provide you with different information. If anyone provides you with different or inconsistent information, you should not rely on it. You should not assume that the information contained in this prospectus or any document incorporated by reference herein is accurate as of any date other than the date on the front cover of the applicable document. Neither the delivery of this prospectus nor any distribution of securities pursuant to this prospectus shall, under any circumstances, create any implication that there has been no change in the information set forth or incorporated by reference into this prospectus or in our affairs since the date of this prospectus. Our business, financial condition, results of operations and prospects may have changed since that date.

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PROSPECTUS SUMMARY

The following summary highlights the key information contained elsewhere or incorporated by reference in this prospectus. It does not contain all the information that may be important to you. You should carefully read this prospectus as well as the documents incorporated by reference in this prospectus in their entirety, especially the discussion of **RISK FACTORS**, before deciding to invest in the notes. In this prospectus, when we use phrases such as **we**, **our** and **us**, we are referring to Environmental Power Corporation and its subsidiaries as a whole, except where it is clear from the context that any of these terms refers only to Environmental Power Corporation or a particular subsidiary.

ENVIRONMENTAL POWER CORPORATION

Overview

We are a developer, owner, and operator of renewable energy production facilities. Our goal is to produce Energy that is . . . Beyond Renewable®, which we define as energy that not only uses waste materials instead of limited resources, but that also is clean, reliable, and cost-effective.

Our wholly owned subsidiary, Microgy, Inc., referred to as Microgy, is a developer of renewable energy facilities for the production and commercial application of methane-rich biogas produced from livestock and food industry wastes, as well as wastes from other organic sources. The biogas is a versatile renewable energy source and can be sold to an end user or used to produce pipeline-grade methane, which we refer to as renewable natural gas, or RNG®, liquefied natural gas, or LNG, compressed natural gas, or CNG, renewable electrical energy or thermal energy as well as other useful by-products. Microgy's systems utilize a proven biogas production technology that we believe is superior to other such technologies.

Microgy intends to continue to focus on a strategy of developing large-scale standardized facilities utilizing an ownership model, pursuant to which Microgy will construct, own and operate facilities and profit from the ongoing sale of biogas or RNG produced by such facilities, as well as sales of greenhouse gas sequestration credits or other marketable environmental benefits. The strategy encompasses the construction and operation of stand-alone plants like the Huckabay Ridge facility described below, as well as facilities dedicated to the needs of a single customer at one or more customer locations. Microgy's goal is to negotiate mid- to long-term offtake arrangements through which it can obtain a premium price for the gas produced by its facilities.

Microgy began commercial operations at the Huckabay Ridge facility in Stephenville, Texas in the first quarter of 2008. Huckabay Ridge consists of eight 916,000-gallon digesters which operate together to process the manure from approximately 10,000 dairy cows. The gas is treated and compressed to produce pipeline-grade methane. Huckabay Ridge is expected to produce approximately 635,000 million British Thermal Units, or MMBtus, of pipeline-grade methane per year.

Microgy also operates three single digester facilities in Wisconsin. In accordance with our previous business model of selling digester facilities to farms, Microgy sold these projects to the farms on which they are located and developed them in conjunction with Dairyland Power Cooperative, an electric cooperative utility, referred to as Dairyland. The biogas from these projects is used by Dairyland to generate electricity.

Environmental Power and Microgy pursue Microgy's business through several subsidiaries and special purpose entities. The principal such entity is Microgy Holdings, LLC, which was formed in 2006 as a subsidiary of Environmental Power Corporation in connection with the \$60 million tax-exempt bond financing we completed in November 2006 relating to the construction and operation of four RNG® facilities in Texas,

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including the Huckabay Ridge facility, and which is the obligor for our \$62.425 million tax-exempt bond financing we completed in September 2008 relating to our proposed California facilities. We currently anticipate pursuing an additional \$26.02 million in tax-exempt bond financing in California. The assets financed by the Texas and California tax-exempt bond financings are pledged as collateral to secure such obligations. The debt held by Microgy Holdings is non-recourse to Environmental Power, although Environmental Power is required to provide at least 20% of the construction costs of these facilities, as well as to cover any cost overruns in construction and certain other costs. Another such entity is Microgy Grand Island, LLC, which was formed to own and operate our facility currently under construction at the JBS Swift & Co. beef processing facility in Grand Island, Nebraska, and which is the obligor under our \$7.0 million tax-exempt bond financing for such facility.

In the past, we operated in two major segments: through Microgy, as described above, and through EPC Corporation and its subsidiary, Buzzard Power Corporation, referred to as Buzzard, as holder of a leasehold interest in a waste-coal fired generating facility in Pennsylvania known as the Scrubgrass facility. On February 29, 2008, we completed the disposition of the leasehold interest in the Scrubgrass facility, as it was no longer within our core business model. As a result, for financial reporting purposes, we are now consolidating all segments of continuing operations and reporting the results of Buzzard as discontinued operations. We now operate only in Microgy's renewable energy segment.

Risk Factors

Investing in the notes involves a high degree of risk. You should carefully consider all of the information included and incorporated by reference in this prospectus. In particular, you should consider carefully the factors discussed under RISK FACTORS beginning on page 7 of this prospectus, before deciding to invest in our common stock.

Corporate Information

Environmental Power Corporation was incorporated in May 2003 and is the successor holding company to our subsidiary, EPC Corporation, which was originally incorporated in Delaware in 1986. EPC Corporation became a publicly traded company in 1986, and its successor, Environmental Power Corporation is currently quoted on The NASDAQ Capital Market (symbol: EPG). The address of our principal executive offices is 120 White Plains Road, Suite 610, Tarrytown, New York 10591-5546 and our telephone number is (914) 631-1435. Our Internet address is www.environmentalpower.com. The information on our Internet website is not incorporated by reference in this prospectus, and you should not consider it to be a part of this document. Our website address is included as an inactive textual reference only.

Ratio of Earnings (Deficit) to Fixed Charges

	Year Ended December 31,				
	2008	2007	2006	2005	2004
Ratio of earnings (deficit) to fixed charges	(4.1)	(4.9)	(29.0)	(39.3)	(60.2)

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THE OFFERING

The Company	Environmental Power Corporation, a Delaware corporation.
Securities Offered	Our 14% Convertible Notes due January 1, 2014, referred to as the notes, in the aggregate original principal amount of \$5,000,000, to be sold in denominations of \$5,000 or whole multiples of \$1,000 in excess thereof.
Unsecured Debt	The debt evidenced by the notes is not secured by any of our assets or any other assets.
Voluntary Conversion	Holders may voluntarily convert the notes into shares of our common stock, \$0.01 par value per share, referred to as the common stock, on any date after the issuance date at a conversion price determined as follows:

Conversion Date	Conversion Price
From the Issue Date through December 31, 2009	\$ 5.40
From January 1, 2010 through December 31, 2010	\$ 6.35
From January 1, 2011 through December 31, 2011	\$ 7.65
From January 1, 2012 through December 31, 2012	\$ 9.75
From January 1, 2013 through December 31, 2013	\$ 11.00

The applicable Conversion Price will be adjusted proportionately if:

we dividend or distribute shares of our common stock to the holders of our common stock;

we split, subdivide or combine our common stock; or

we reclassify or recapitalize our common stock.

Repurchase Upon a Change in Control	Upon the acquisition by a person or group of persons acting in concert of a majority of the voting shares (including warrants or rights to purchase or exchange for voting shares) of Environmental Power Corporation, referred to as a Change in Control, holders of the notes will have the right to require us to repurchase, and we will have the right to require holders of the notes to sell to us, all or any portion of the notes at a price described herein.
Mandatory Conversion at Our Option or Redemption	At any time after the third anniversary of the date of the first issuance of notes (March 13, 2009), we may require the holders to convert all of the notes into common stock if at the time less than 20% of the aggregate principal amount of securities originally issued remain outstanding and the conversion market price is greater than the stock price on the date the notes were originally issued, provided that such holders shall have the right to elect not to have their securities converted to common stock, in which case their securities shall be redeemed at the redemption price equal to 110% of the principal

amount thereof, plus accrued interest.

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Optional Redemption	At any time after the third anniversary of the date of first issuance of the notes (March 13, 2009), we have the right to redeem all or part of the notes at a redemption price equal to 110% of the principal amount of the notes to be redeemed plus accrued interest through the day prior to the redemption date, provided that our common stock has traded at a volume weighted average price of at least \$6.40 per share for the 45-day period ending on the date immediately prior to the date on which we give notice of such redemption.
Mandatory Redemption upon Certain Sales of Assets or Certain Sale and Leaseback Transactions	The notes are subject to redemption in whole or in part at a redemption price equal to 100% of the principal amount of the notes to be redeemed plus accrued interest through the day prior to the redemption date, to the extent that we or one of our subsidiaries engaged in an Asset Sale, as defined, or certain sale and leaseback transactions, and the net proceeds of such Asset Sale or sale and leaseback transactions are not reinvested in a permitted business as described herein, within two years of the receipt thereof.
Maturity Date	January 1, 2014.
Interest Rate Calculation	The interest rate on the notes will be calculated on the basis of a 360-day year of twelve 30-day months.
Interest Payment Dates	Interest on the notes will be payable January 1 and July 1 of each year commencing July 1, 2009, and on any date the principal of the notes is paid, including at maturity or if such day is not a business day, the immediately succeeding business day, and on any conversion date applicable to such notes (except as otherwise provided herein), each of which is referred to as an interest payment date.
Defaults and Remedies	The principal of and accrued interest on all of the notes may be declared immediately due and payable upon the occurrence and continuation of certain events of default described in the Trust Indenture, dated as of March 1, 2009, by and between us and Wells Fargo Bank, National Association, in its capacity as trustee, paying agent, registrar and exchange agent, referred to as the trustee, as amended and supplemented by the First Supplemental Trust Indenture, dated as of March 1, 2009. The Trust Indenture, as so amended and supplemented, is referred to as the indenture. <i>See</i> DESCRIPTION OF THE NOTES AND THE INDENTURE Events of Default and Remedies.
Outstanding and Additional Notes	The indenture provides that we may issue notes having an aggregate principal amount of \$53,000,000, inclusive of the principal amount of the notes offered hereby and notes currently outstanding. As of the date hereof, we have issued \$5,000,000 aggregate original principal amount of the notes under the indenture. We may issue additional notes from time to time up to this aggregate amount.

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Trustee, Exchange Agent, Paying Agent and Registrar Wells Fargo Bank, National Association.

Amendments to Indenture	We and the trustee have the right to amend the indenture in certain instances without the consent of the holders of the notes. <i>See</i> DESCRIPTION OF THE NOTES AND THE INDENTURE.
Payments	We are required to pay to the trustee, on each interest payment date, the amount necessary to make the amount on deposit in the interest account equal to the amount of accrued and unpaid interest on the notes payable on that interest payment date. We are required to pay to the trustee such amounts as are required to pay the principal or the redemption price of the notes at the time and in the manner provided in the indenture. No payment of principal is scheduled to be made until the maturity date. <i>See</i> DESCRIPTION OF THE NOTES AND THE INDENTURE.
Risk Factors	Investment in the notes involves a high degree of risk. There are a number of risks that may affect the repayment of the notes. <i>See</i> RISK FACTORS.
Federal Income Tax Consequences	Some federal income tax consequences are associated with purchasing, holding and disposing of the notes. Prospective investors are urged to consult their own tax advisors regarding the tax consequences of acquiring, holding or disposing of the notes. <i>See</i> CERTAIN U.S. FEDERAL INCOME TAX CONSIDERATIONS.
Net proceeds	We estimate that the net proceeds from this offering will be approximately \$4,475,000, after deducting the underwriting discount and commission and the estimated offering expenses payable by us.
Use of proceeds	Our subsidiary, Microgy Holdings, LLC, referred to as Microgy Holdings, has, together with its subsidiaries, entered into project financings in Texas, California and Nebraska in the form of tax-exempt bond financings described elsewhere in this prospectus. The proceeds of the notes will be contributed by us as equity to Microgy Holdings or Microgy Grand Island, LLC pursuant to the support agreements entered into by us in connection with the Texas, California and Nebraska project financings, which require us to make these equity contributions to fund certain costs relating to the construction and operation of the facilities. In addition, we are issuing the notes pursuant to the loan agreement and related documentation entered into by Microgy Holdings in connection with the California project financing, which includes as a condition to Microgy Holdings' ability to draw the proceeds of such financing that we raise at least \$45 million in additional capital, of which \$17.5 million must be available for the construction and operation of Microgy Holdings' facilities in California. In the event that we do not sell any additional bonds to finance our proposed Bar 20 facility in California, the Bar 20 facility, which is currently a proposed part of such facilities, will not

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be part of such California project, and the foregoing capital requirements will be reduced to \$39,825,000 and \$12,325,000, respectively.

The costs of construction and operation of the Texas, California and Nebraska facilities which may be funded with the proceeds of this offering include, among other things, costs of materials, equipment and labor, debt service, license fees which may become due to Danish Biogas Technology, A.S. referred to as DBT, the licensor of Microgy's anaerobic digestion technology, under Microgy's license agreement with DBT, operations and maintenance costs, and reimbursement or repayment of Environmental Power or its affiliates of equity contributions, subordinated debt or other project-related expenses advanced by us or such affiliates in anticipation of receipt of the proceeds of this offering.

We will need to raise substantial additional financing, in addition to the proceeds of this offering, in the first half of 2009, as outlined above, to finance development and construction of our planned projects, to fund ongoing general and administrative expenses associated with our corporate overhead, as well as interest and dividend requirements, and to continue as a going concern. If we are unable to raise sufficient additional financing on a timely basis, we may have to reduce the number of projects we construct, or even curtail or cease our business operations.

Source of Repayment of the Notes

We intend to repay the notes from cash flow derived by us from our ownership and operation of Microgy's projects in California, Texas, Nebraska and elsewhere, or from other sources of income we may develop from time to time.

Book-Entry, Delivery and Form

The notes will initially be issued in the form of one or more global securities registered in the name of The Depository Trust Company, referred to as DTC, as depository, or a nominee of the depository. A global security may not be transferred or registered in the name of anyone other than the depository, its nominee or a successor depository, unless special termination situations arise. Only the person in whose name a note is registered is recognized as the holder of that note. Consequently, for notes issued in global form, we will recognize only the depository as the holder of the notes, and we will make all payments on the notes to the depository. *See* DESCRIPTION OF THE NOTES AND THE INDENTURE Legal Ownership of Securities.

Notes Not Listed for Trading

The notes are not expected to be listed for trading on any market. Our common stock is traded on The NASDAQ Capital Market under the symbol EPG.

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RISK FACTORS

Investing in our securities, including the notes and our common stock, involves a high degree of risk. Prospective purchasers are advised to read this prospectus, as well as each of the documents incorporated by reference in this prospectus, in their entirety. Prospective investors should carefully consider the following risk factors, as well as other information set forth in this prospectus and the documents incorporated by reference, before making an investment in the notes.

The risks and uncertainties described below are not the only ones facing our company. Additional risks and uncertainties may also impair our business operations and adversely affect our prospects. The order in which such risks are presented does not necessarily reflect the relative importance of such risks or the likelihood that any of the events or circumstances described below will occur or exist.

If any of the following risks actually occur, our business, financial condition or results of operations would likely suffer. In that case, the trading price of our common stock could fall, we may not be able to make timely payments, or any payments, on amounts owed under the notes, and you may lose all or part of the money you paid to buy the notes.

Risks Relating to Our Business

We have experienced losses to date, and we anticipate that we will continue to experience losses through at least 2010, which means that we will have to raise significant additional financing in the first half of 2009 in order to continue our business operations.

We are a company in the process of pursuing an aggressive and novel business approach to the construction and operation of renewable energy facilities and the production of renewable natural gas. As noted below, our sole operating business, Microgy, is in the early stages of its development. As a result, we have a history of losses. For the year ended December 31, 2008 we incurred a net loss from continuing operations of \$22,996,000, which includes a non-cash, non-recurring expense for the impairment of goodwill of \$4,913,000. For the years ended December 31, 2007 and 2006, we incurred net losses from continuing operations of \$11,161,000, and \$11,399,000, respectively. We expect to continue to incur losses, reduce our earnings or, as the case may be, add to our earnings deficit as we seek to further develop our business. We currently expect that these ongoing losses will adversely affect our financial condition through at least 2010. As a result of these losses, we anticipate that we will, in all likelihood, have to rely on external financing for most of our capital and operational requirements. Even after completion of this offering, we will need to raise substantial additional financing in the first half of 2009 in order to finance development and construction of our planned projects, to fund ongoing general and administrative expenses associated with our corporate overhead as well as interest and dividend requirements and to continue as a going concern. We currently have no commitments for any such financing. We cannot assure you such financing will be available on reasonable terms or in a timely fashion, or at all, particularly in the current economic environment, in which capital raising activities are especially challenging. Future losses are likely to continue unless we successfully implement our business plan. If we are not successful in reaching and maintaining profitable operations, we may not be able to attract sufficient capital to continue our operations and avoid defaulting on our corporate and subsidiary debt and other obligations. Our inability to obtain adequate financing would likely result in the need to reduce the number of projects we construct and even to curtail or cease our business operations and would materially impair the value of your investment in our securities, including the notes and our common stock.

Our sole operating business, Microgy, has limited operating history from which to evaluate its business and products.

Our sole operating business, Microgy, was formed in 1999 and remains in the early stages of its development. Microgy is developing facilities that use environmentally friendly anaerobic digestion and other technologies to produce biogas from animal and organic wastes. Although Microgy has developed and is operating three single digester facilities in Wisconsin and the multi-digester Huckabay Ridge facility, Microgy

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still has limited experience in the construction and operation of multiple digester facilities such as those Microgy is currently constructing or intends to construct, and limited experience in gas conditioning or the sale of gas as a commodity. In addition, Microgy has experienced challenges during the startup and initial operation of the Huckabay Ridge facility that have resulted in outages for corrective measures. We took advantage of such an outage to complete comprehensive upgrades to process-instrumentation and controls, the gas conditioning system, and the gas-collection system in order to achieve anticipated performance levels. While we gained valuable knowledge as to our processes and incorporated the lessons learned into future projects, we cannot assure you that similar challenges will not be encountered with respect to future facilities. Because of Microgy's limited experience, there is a risk that Microgy may never be profitable.

Microgy cannot predict when any facility will be completed, what Microgy's costs will be or, consequently, whether Microgy or any facility developed by Microgy will be profitable.

Development of Microgy's facilities is an inherently risky activity, subject to significant uncertainties and a lengthy development cycle. Uncertainties and risks include those relating to costs and availability of supplies and labor, costs and quality of facility components and installation services, fluctuations in the prices available for the sale of facility output and timing of completion of construction and commencement of commercial operations. Furthermore, obtaining the large number of agreements, permits and approvals necessary to develop, install, operate and manage any of Microgy's facilities, as well as to market the energy and other co-products and to provide necessary related resources and services, involves a long development cycle and decision-making process. Microgy is required to enter into or obtain some or all of the following in connection with the development of its facilities:

Off-take interconnection agreements;

Site agreements;

Supply contracts;

Design/build or other construction-related agreements;

Off-take agreements for gas produced;

Power sales contracts for facilities dedicated to the generation of electricity;

Agreements for the sale of greenhouse gas offset credits or other tradable environmental attributes;

Various co-product sales agreements;

Waste disposal agreements;

Environmental and other permits and licenses;

Government approvals; and

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Financing commitments required for the successful completion of facilities under consideration.

Microgy's failure to accomplish any of these objectives could materially increase the cost, or prevent the successful completion of, development or operation of facilities and incur the loss of any investment made. Many of these objectives are dependent upon decisions by third parties. Delays in such parties' decision-making process are outside of our control and may have a negative impact on our development costs, cost of operations, receipt of revenue and revenue projections. We expect that, in some cases, it may take a year or more to obtain decisions on permits and approvals and to negotiate and close these complex agreements. Such delays could harm our operating results and financial condition.

As a result of the foregoing uncertainties we are unable to project with certainty Microgy's organizational, structural, staffing or other overhead costs, the construction or operating costs associated with any facility, or whether any facility, or Microgy as a whole, will generate a profit. If Microgy fails to generate a profit, your investment in our securities will be materially adversely affected.

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If we are unable to obtain needed financing for Microgy's facilities, the value of our Microgy investment may be reduced significantly.

Because we have not yet generated sufficient positive cash flow, and do not expect to do so until at least 2011, we do not have adequate funds on hand to complete construction of the facilities we currently have planned. We are seeking and will require corporate, project or group financing to fund the cost of any development we may decide to pursue for Microgy's facilities. This financing may be difficult or impossible for us to obtain, particularly in the current economic environment, in which capital raising activities are especially challenging. If we are unable to obtain such financing, the value of our Microgy investment may be reduced significantly, and we may be required to substantially curtail our business or completely cease construction or operation of any facilities. The availability of additional financing will depend on prospective lenders' or investors' review of our financial capabilities as well as specific facilities and other factors, including their assessment of our ability to construct and manage each facility successfully and the current state of the economy. Such financing may not be available to us on acceptable terms, or at all. If we are unable to obtain the required financing, we will have to reduce the number of projects we construct and may even have to curtail or cease our business operations, which would have a material adverse effect on your investment in our securities.

If Microgy is unable to obtain sufficient manure and substrate for its facilities at an acceptable cost, such facilities, and Microgy as a whole, will likely not be profitable.

The performance of Microgy's facilities is dependent on the availability of large quantities of animal manure and substrates derived from animal and other organic waste resources to produce raw energy and meet performance standards in the generation of renewable natural gas. A substantial portion of the gas production of Microgy's facilities is derived from the co-digestion contribution enabled by substrate. While Microgy has or is expected to have agreements relating to the supply of manure and substrate, these agreements may not cover all of Microgy's requirements for such resources, and Microgy will be subject to the ability of the counterparties to such agreements to perform their obligations thereunder. Lack of manure or substrate or adverse changes in the nature or quality of such waste resources or the cost to supply or transport them would seriously affect the ability of Microgy's facilities to produce gas at profitable levels and, consequently, its ability to develop and finance facilities and to operate efficiently and generate income. As a result, its revenue and financial condition would be materially and negatively affected. We cannot assure you that the waste resources Microgy's facilities require will be available in the future for free or at prices that make them affordable or accessible.

Microgy is expected to derive a significant portion of its revenues from the sale of renewable natural gas; as a result it may have some exposure to volatility in the commodity price of natural gas.

Microgy is expected to derive a significant portion of its revenues from the sale of renewable natural gas. Microgy typically enters into medium-to-long-term off-take arrangements for the gas produced by its facilities as part of the planning and development of such facilities, and may enter into other hedging arrangements, in order to mitigate the associated commodity price risk. Furthermore, our subsidiary, Microgy Holdings, is required by the terms of its tax-exempt bonds to maintain certain gas price protection arrangements for specified periods of time. We believe that these arrangements will be considered normal purchases and sales and will not be subject to derivative accounting. However, there may be times when such off-take and hedging arrangements expire or otherwise terminate before new arrangements are put in place, and such arrangements are subject to the creditworthiness of the counterparties to them. In addition, we cannot assure you that any such risk management vehicles will always be available or successful. Because renewable natural gas commands a premium over, but still tracks prices for, conventional natural gas, Microgy will be exposed, to the extent not covered by long-term contracts, to market risk with respect to the commodity pricing of conventional natural gas. Historically, natural gas prices have been volatile and Microgy expects such volatility to continue.

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We expect revenues from sales of greenhouse gas sequestration credits and other environmental attributes, but the market for such attributes is nascent and may not develop in a manner that allows us to profit from the sales of such credits to the level projected, or at all.

The multiple digester facilities that we plan to implement through Microgy Holdings and our other subsidiaries are expected to produce greenhouse gas offset credits and other marketable environmental attributes. While there exist trading markets for these attributes, and additional trading markets or other commercial avenues may develop, the existing trading markets are new and experience thin trading and price volatility, which can hinder sales of credits and make their value unpredictable. The quantity of credits that may be generated are a function of the carbon credit offset characteristics as determined by protocols used to document and verify the carbon offset value. These protocols continue to evolve, and changes in these protocols could substantially diminish further carbon credit eligibility. Furthermore, much of the participation in these markets is voluntary, in response to social and environmental concerns, as opposed to being driven by regulatory requirements. While many states and the federal government are pursuing or are considering carbon emissions limits and related initiatives that may spur greater development of and participation in these markets, we are unable to determine the effect of these initiatives on these markets. We cannot assure you that these trading markets will develop further, or even that they will continue to exist. In addition, many of our agreements with our business partners and investors require us to share such credits or any revenues we derive from sales of such credits, and agreements we negotiate in the future may also include such requirements. As a result of the foregoing, we may recognize significantly smaller revenues than we anticipate from the sale of greenhouse gas sequestration credits or other environmental attributes.

We have pledged all of our interest in our facilities in Texas and California as security for the loans relating to Microgy Holdings tax-exempt bond financings in those jurisdictions, and our subsidiary, Microgy Grand Island, LLC, has entered into a financing lease with respect to the Grand Island facility.

We have invested, and expect to invest, substantial funds and resources in the Huckabay Ridge facility and the other multi-digester, renewable natural gas facilities in Texas, California and Nebraska. We have pledged all of our interest in the Huckabay Ridge facility, as well as the Rio Leche, Cnossen and Mission facilities in Texas as collateral security for the loan to our subsidiary, Microgy Holdings, from the Gulf Coast Industrial Development Authority of Texas relating to the \$60 million tax-exempt bond financing we completed in November 2006. We have pledged all of our interest in the Riverdale and Hanford facilities in California as collateral security for the loan to our subsidiary, Microgy Holdings, from the California Statewide Communities Development Authority relating to the \$62.425 million tax-exempt bond financing we completed in September 2008, and we expect to pledge all of our interest in the proposed Bar 20 facility in California if we pursue and are successful in closing a \$26.02 million second tranche of such financing. While these loans are non-recourse to Environmental Power, Environmental Power is required to provide at least 20% of the construction costs of these facilities, as well as to cover any cost overruns in construction and certain other significant costs, which represents a substantial investment of corporate resources. If Microgy Holdings were to default on these loans, we would lose some or all of our investment in the Texas and California facilities, which would have a material adverse effect on our business, financial condition and results of operations. In addition, our subsidiary, Microgy Grand Island, LLC, has entered into a \$7.0 million sale and leaseback transaction with the City of Grand Island, Nebraska in connection with its tax-exempt bond financing in Nebraska to finance the construction of the Grand Island facility, and has guaranteed the City's obligations under the tax-exempt bonds. Environmental Power has equity contribution and support obligations with respect to the Grand Island facility that are substantially similar to those under the Texas and California financings. If Microgy Grand Island defaults on its lease and guarantee obligations to the City of Grand Island, we would lose some or all of our investment in the Grand Island facility, which would have a material adverse effect on our business, financial condition and results of operations.

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Microgy faces competition in the renewable energy market as well as for the resources necessary to operate its facilities.

Microgy plans to generate revenue from the development and ownership of facilities that market renewable, green energy in addition to providing pollution control features to the agricultural and food industry markets. Microgy's green competitors include other energy producers using biomass combustion, biomass anaerobic digestion, geothermal, solar, wind, new hydro and other renewable sources. These companies represent a significant class of competitors because they will compete with Microgy for sale of marketable renewable energy credits and participation in various renewable portfolios and other programs.

Competition in the traditional energy business from electric utilities and other energy companies is well established, with many substantial entities having multi-billion dollar, multi-national operations. Many of these companies are beginning to compete in the alternative fuels and renewable energy business with the growth of the industry and the advent of many new technologies. Larger companies, due to their greater financial and other resources, will be better positioned than Microgy to develop new technologies and to install existing or more advanced renewable energy facilities, which could harm Microgy's business.

Microgy also faces many forms of competition with respect to the resources required to operate its facilities. Such competition includes other providers of pollution control, including environmental engineers, providers of pollution control systems, private companies, public companies, associations, cooperatives, government programs, foreign companies, and educational pilot programs. Furthermore, there are many companies that offer anaerobic digester systems. A number of these competitors have more mature businesses and have successfully installed anaerobic digester systems in the United States. Microgy may be forced to compete with any of these competitors for access to equipment, construction supplies, skilled labor for the construction and operation of its facilities and the supplies of manure and substrate required to operate its facilities. In addition, Microgy may also have to compete for access to substances that make desirable substrates with other users of these substances, such as recyclers of waste grease and producers of biodiesel and other biofuels. The effect of such competition could be reflected in higher costs associated with obtaining access to these resources, as well as an insufficient supply of these resources for the profitable operation of Microgy's facilities. If Microgy cannot obtain and maintain these supplies, or cannot obtain or maintain them at reasonable costs, the profitability of Microgy's business will be adversely affected.

Extreme weather events may have a material adverse effect on the operation on our facilities.

Microgy's facilities and sites are sensitive to extreme weather events. For instance, the anaerobic digestion process requires temperatures within a certain band, and extreme cold or heat may negatively impact the process or increase operating costs as a result of the need to counter such temperatures. This was the case in early 2007, when Texas experienced record cold temperatures that hindered startup of the Huckabay Ridge facility. Also, our sites contain retention ponds that have been designed with ample capacity to collect and retain storm water run-off, but, despite applying best maintenance practices, that capacity on rare occasions can be strained by severe rainfall. Thus, in August 2008, a 25-year record rainfall event caused a storm water retention pond breach and spill that required cleanup of a dry creek bed and reporting to the local environmental authorities. While Microgy considers typical local weather conditions in the design of its facilities and maintains appropriate insurance to mitigate associated risks to the extent commercially feasible, Microgy cannot anticipate all unusual weather events, and such events have had and may in the future have a material adverse effect on the operation of its facilities.

It is possible that we may expend large sums of money on individual projects to bring Microgy's products to market and that the revenue that Microgy derives from these products from new projects may be insufficient to fund our operations.

Microgy's business approach to the renewable energy may not produce results as anticipated, be profitable or be readily accepted by the marketplace. We cannot estimate whether the gas produced by facilities based on Microgy's technology will materialize at anticipated prices, or whether satisfactory profit margins will be

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achieved. If such pricing levels are not achieved or sustained, or if Microgy's technologies and business approach to Microgy's markets do not achieve or sustain broad acceptance, our business, operating results and financial condition will be materially and negatively impacted.

Because we have not filed patents to protect Microgy's intellectual property, we might not be able to prevent others from using Microgy's technology; conversely, others who have filed for patent or other protection might be able to prevent Microgy from using its technology.

Microgy has not filed any patent applications on any of its intellectual property. Should Microgy decide to file patent applications, we cannot assure you that any patent applications relating to Microgy's existing or future products or technologies will result in patents being issued, that any issued patents will afford adequate protection to Microgy, or that such patents will not be challenged, invalidated, infringed or circumvented. Furthermore, we cannot assure you that others have not developed, or will not develop, similar technologies that will compete with Microgy's without infringing upon Microgy's intellectual property rights or those of its licensor.

Third parties, including potential competitors, may already have filed patent applications relating to the subject matter of Microgy's current or future technology. In the event that any such patents are issued to such parties, such patents may preclude Microgy or its licensor from obtaining patent protection for its technologies, products or processes. In addition, such patents may hinder or prevent Microgy from commercializing its technology and could require Microgy to enter into licenses with such parties. We cannot assure you that any required licenses would be available to us on acceptable terms, or at all.

Microgy relies on confidentiality agreements and licensing agreements to maintain the proprietary nature of its technology. To compete effectively, Microgy may have to defend the rights to its intellectual property from time to time. Such defense costs may be significant and have a negative impact on our financial condition. In addition, we may lack the financial resources to adequately defend Microgy's intellectual property.

Microgy's facilities are likely to be subject to numerous governmental regulations.

We expect that Microgy's facilities are likely to be subject to various local, state and federal government regulations, including regulations covering air and water quality, solid waste disposal and related pollution issues. These regulations are mandated by the United States Environmental Protection Agency, or EPA, and state and local governments and are usually implemented through a permitting process, with ongoing compliance requirements thereafter. For example, grease-trap waste from restaurants and other food service providers is a desirable and highly available form of substrate for our facilities in Texas. However, the Texas environmental authorities required that we obtain a solid-waste permit for each of our planned facilities in Texas to the extent we desire to use grease-trap waste as substrate in the operation of such facilities. Furthermore, we have had to obtain water discharge permits for our planned California facilities, which typically involve a lengthy process. We expect that all of our facilities will be required to obtain various environmental and other permits and approvals, which will vary from location to location. In addition, our activities will fall under a number of health and safety regulations and laws and regulations relating to farming and zoning. Compliance with these regulations and permitting requirements could delay the development of facilities and could be costly and harm our financial condition.

Microgy's facilities may become subject to regulations or taxes based on carbon or other emissions.

Microgy's facilities produce and emit into the atmosphere carbon dioxide and hydrogen sulfide as a result of the anaerobic digestion gas conditioning processes that they employ. While such facilities capture and thereby reduce the amount of methane, a potent greenhouse gas, that would otherwise enter the atmosphere, there are direct emissions of carbon dioxide, another greenhouse gas. As such, Microgy's facilities may still be subject to future federal or state legislation or regulation, or the implementation of international treaties, which seek to limit

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or impose a cost on greenhouse gas emissions. If any such legislation, regulations or treaties were implemented, Microgy may be required to expend resources to capture the carbon dioxide it produces, pay a tax on its carbon dioxide emissions, purchase greenhouse gas offset credits, reduce the greenhouse offset credits claimed for such facilities or take similar actions. In addition, Microgy could become subject to federal, state and local taxes and regulations regarding its other emissions. Any of the foregoing could harm the profitability of Microgy's facilities.

Our operating results are difficult to predict in advance and may fluctuate significantly, which may result in a substantial decline in our stock price.

Our operating results are difficult to predict in advance and may fluctuate significantly, and a failure to meet the expectations of analysts or our stockholders would likely result in a substantial decline in our stock price.

Factors that are likely to cause our results to fluctuate include the following:

the amount and timing of our operating expenses and capital expenditures;

the success or failure of the facilities currently underway;

our ability to specify, develop and complete facilities, and to introduce and market the energy created by such facilities and bring them to volume production in a timely manner;

the rate of adoption and acceptance of new industry standards in our target markets; and

other unforeseen activities or issues.

If our operating results fluctuate greatly, our business may be materially adversely affected and our stock price will likely decline.

Risks Relating to Our Capital Stock

We have numerous outstanding shares of restricted common stock, as well as options, warrants and shares of preferred stock exercisable or convertible into a substantial number of shares of our common stock; the resale of outstanding restricted shares, as well as the exercise or conversion of these securities and the resale of the underlying shares, may adversely affect the price of our common stock.

The resale by our stockholders of shares of our restricted common stock or securities exercisable for or convertible into shares of our common stock could cause the market price of our common stock to decline.

A significant portion of our outstanding shares of common stock had been restricted from immediate resale, but is now available for sale in the market pursuant to Rule 144 under the Securities Act of 1933. As of December 31, 2008, we had approximately:

15,614,604 shares of our common stock issued and outstanding, of which 1,212,726 shares of common stock outstanding are restricted securities within the meaning of Rule 144 and 35,250 shares are subject to vesting pursuant to restricted stock awards granted to certain employees; and

2,823,659 shares of common stock issuable upon conversion of our series A preferred stock; all of which shares, other than employee restricted stock awards subject to vesting, are eligible for resale without volume and manner of sale restrictions in accordance with Rule 144, except to the extent held by our affiliates. We are currently authorized to issue 50,000,000 shares of

common stock.

We also currently have on file with the Securities and Exchange Commission an effective registration statement that permits the resale of up to 100,000 shares of our common stock subject to warrants exercisable at a price of \$6.33 per share by the holders of such warrants. In addition, in connection with our sale of shares of our series A preferred stock and common stock warrants on November 9, 2006, we filed a registration statement to

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permit the resale of up to 4,387,360 shares of common stock issuable upon conversion of such shares of series A preferred stock and exercise of such warrants, which registration statement is currently effective. The shares of series A preferred stock were convertible at a conversion price of \$5.27 per share, and the common stock warrants were exercisable at a price of \$5.52 per share as to 1,406,205 of the warrants, and \$5.27 per share as to 168,745 of the warrants. In October 2007, the exercise price of the warrants was reduced to \$5.25 per share, and the preferred stock conversion price was reduced to \$5.25 per share as a result of anti-dilution adjustments triggered by the issuance of common stock in the October 2007 public offering, resulting in an increase of 11,250 in the number of shares of our common stock issuable upon conversion of the series A preferred stock.

In addition, pursuant to our business development agreement with Cargill, Incorporated, we may issue warrants to Cargill from time to time to acquire up to an aggregate of 4.99% of our outstanding common stock on a fully diluted basis, at an exercise price equal to 75% of the closing price of our common stock on the date on which such warrants are issued. In May 2007, we issued to Cargill warrants to purchase 175,912 shares of our common stock at an exercise price of \$5.37 per share, representing 1% our fully diluted common stock at the time, as required by the business development agreement.

We currently have outstanding \$5 million original principal amount of the notes. These notes are convertible into an aggregate of up to approximately 925,926 shares of our common stock, based upon the minimum conversion price of the notes, all of which shares may be sold by the holders thereof without restriction, except to the extent held by our affiliates.

The notes issued in this offering will be convertible into an aggregate of up to approximately 925,926 shares of our common stock, based on the minimum conversion price of the notes, all of which shares may be sold by the holders thereof without restriction, except to the extent held by our affiliates.

As of December 31, 2008, we had outstanding options and warrants to acquire up to approximately 4,905,935 shares of our common stock at prices ranging from \$1.75 to \$8.89 per share, with a weighted average exercise price of \$2.98 per share. The shares of common stock issuable upon exercise of these options will be freely transferable without restriction, except to the extent that they are held by our affiliates. Any shares held by our affiliates may only be sold in compliance with the volume limitations of Rule 144. These volume limitations restrict the number of shares that may be sold by an affiliate in any three-month period to the greater of 1% of the number of shares then outstanding, which equals approximately 156,000 shares as of December 31, 2008, or the average weekly trading volume of our common stock during the four calendar weeks preceding the filing of a notice on Form 144 with respect to the sale.

As a result of the resale of outstanding s