ENVIRONMENTAL POWER CORP
Form 10-K/A
April 30, 2007
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

Form 10-K/A

FOR ANNUAL AND TRANSITION REPORTS PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

(Mark One)

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

For the fiscal year ended December 31, 2006

OR

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

For the transition period from to

Commission file number: 001-32393

ENVIRONMENTAL POWER CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**75-3117389**
(State or other jurisdiction of incorporation or organization)	***(IRS Employer Identification Number)***
One Cate Street, 4th Floor, Portsmouth, New Hampshire	**03801**
(Address of principal executive offices)	***(Zip Code)***

Registrant s telephone number, including area code:

(603) 431-1780

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Exchange on Which Registered
Common Stock, $0.01 par value per share	**American Stock Exchange**

Securities registered pursuant to Section 12(g) of the Act:

None

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

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

Large Accelerated Filer ¨ Accelerated Filer ¨ Non-Accelerated Filer x

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

The aggregate market value of the registrant s common stock held by non-affiliates of the registrant as of June 30, 2006, was approximately $55 million based on $6.55, the price at which the registrant s common stock was last sold on that date.

As of February 28, 2007, the registrant had 9,652,025 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Not Applicable.

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EXPLANATORY NOTE

This amendment on Form 10-K/A to the Annual Report of Environmental Power Corporation on Form 10-K for the fiscal year ended December 31, 2006 (the Annual Report) of Environmental Power Corporation (we, us, the Company or EPC) filed on March 30, 2007 with the Securities & Exchange Commission (the SEC) is being filed solely for the purpose of including information that was to be incorporated by reference from the Company s definitive proxy statement pursuant to Regulation 14A of the Securities and Exchange Act of 1934. The Company will not file its proxy statement within 120 days of its fiscal year ended December 31, 2006 and is, therefore, amending and restating in their entirety Items 10, 11, 12, 13 and 14 of Part III of the Annual Report. In addition, in connection with the filing of this Amendment and pursuant to Rules 13a-14(a) or 15d-14(a) under the Securities Exchange Act of 1934, we are including with this Amendment certain currently dated certifications. Except as described above, no other amendments are being made to the Annual Report. This Form 10-K/A does not reflect events occurring after the March 30, 2007 filing of our Annual Report, and does not modify or update the disclosure contained in the Annual Report in any way other than as required to reflect the amendments discussed above and reflected below.

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ENVIRONMENTAL POWER CORPORATION

ANNUAL REPORT

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PART III

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PART III

ITEM 10. ***DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE***
Directors

Joseph E. Cresci, age 64, is a founder of our Company and has served as our Chairman since its inception in 1982 and as Chief Executive Officer from 1982 to July 2003. Previously, Mr. Cresci had held other senior management positions including CEO/Owner of a distribution business and President/COO of a subsidiary of a New York Stock Exchange listed company. Mr. Cresci holds an A.B. degree from Princeton University and a law degree from Cornell Law School and was a member of the Pennsylvania and Massachusetts bars.

Kamlesh R. Tejwani, age 46, has been our non-executive Vice Chairman since July 2006. From July 2003 to July 2006, Mr. Tejwani served as our President and Chief Executive Officer. Mr. Tejwani served as President of Target Capital Corporation, a private equity firm, from May 1996 to June 2003. His responsibilities included structuring and implementing investments for an offshore investment fund and assisting operating companies in operational and strategic planning. From April 1990 until December 1995, he served as the Chairman and Chief Executive Officer of Air-Cure Technologies, Inc., a manufacturer and marketer of air pollution control systems.

John R. Cooper, age 59, has been a director since 2003. Since 2002, he has been President of Finance of Energy Advisory Services, LLC, a financial structuring and energy consulting group. Until 2002, Mr. Cooper was a founding member of the management team at PG&E s National Energy Group (and predecessor companies). As Senior Vice President and Chief Financial Officer, he oversaw all aspects of the structuring and arranging of financing for National Energy Group s projects, energy trading operations, mergers and acquisitions and equity sell-downs, and was responsible for all corporate finance, treasury and insurance activities. Previously, he spent eight years with Bechtel Financing Services, Inc., where he was responsible for structuring and arranging financing for large infrastructure and energy projects. He spent three years as chief financial officer of a European oil, shipping, banking and venture capital group in Geneva, Switzerland. He is currently a Director of MachGen, LLC, SkyFuel, LLC and an advisory director of Republic Financial Corporation. He is also a founding principal, Chief Financial Officer and Director of Ocean Renewable Power Company, LLC. Mr. Cooper holds a bachelor s degree from Trinity College (Connecticut), a master s degree in development economics and international studies from the Johns Hopkins Nitze School of Advanced International Studies, and a master s degree in finance from the Kellogg Graduate School of Management at Northwestern University.

August Schumacher, Jr., age 67, has been a director since 2002. Mr. Schumacher served as the third-highest ranking official in the United States Department of Agriculture in the Farm and Foreign Agricultural Service from 1997 to 2001. During this time, he was also President of the USDA s Commodity Credit Corporation. Prior to his appointment, he directed the Department s Foreign Agricultural Service. Earlier, Mr. Schumacher was the Senior Agricultural Project Manager for World Bank and also served as the Commissioner of Food and Agriculture for the Commonwealth of Massachusetts. He also serves as a consultant for W.K.K. Kellogg Foundation and, from 2001 to 2006, directed the Washington office of the SJH & Company, Inc. of Boston, Massachusetts, a consulting firm. Mr. Schumacher is currently a non-executive consultant to SJH & Company.

Robert I. Weisberg, age 60, has been a director since 1994. He is President and Chief Executive Officer of Alco Financial Services, LLC, a commercial asset-based lending company, and Chairman and CEO of Oceans Casino Cruises, Inc., a publicly-traded operator of casino cruise ships. He was the former President and Chief Executive Officer of Pro-Care Financial Group, Inc., and has held the positions of President and CEO of Fleet Credit Corporation and Executive Vice-President of Fleet Financial Group. A graduate of Northeastern University, he received the Executive Award from a joint program sponsored by Williams College and the Harvard Graduate School of Business. Past Chairman and President of the Commercial Finance Association, he is presently a member of the Commercial Finance Association s Education Foundation. Mr. Weisberg is a trustee of the Monterey Mutual Fund, and has served on numerous other public, corporate and non-profit community boards. He is a Governing Member of the Reed Union School Board and Chair of Fundraising.

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Lon Hatamiya, age 48, has been a Director of LEGC, LLC, an international expert consulting firm serving businesses and public agencies specializing in economic analysis and development, intellectual property valuation, international trade and related matters, since January 2004. From December 2003 to March 2004, he was an advisor to Declare Yourself, a non-profit, non-partisan organization focused on motivating young voters. From January 1999 to November 2003, Mr. Hatamiya was Secretary of the State of California s Technology, Trade and Commerce Agency and Chairman of the Board of the California Infrastructure and Economic Development Bank. From September 1993 to January 1999, Mr. Hatamiya held various positions in the United States Department of Agriculture, including being Vice President of the Credit Commodity Corporation, and Administrator of the Agricultural Marketing Service and the Foreign Agricultural Service. He also practiced law with the international firm of Orrick, Herrington and Sutcliffe. Mr. Hatamiya holds a B.A. in Economics from Harvard University, an M.B.A. in International Business and Entrepreneurial Studies from the UCLA Anderson Graduate School of Management, and a J.D. from the UCLA School of Law.

Steven Kessner, age 54, has been the Chairman of the Board and President of The R.E. Group since 1981. In this capacity, Mr. Kessner has overseen the management and operation of the various real estate holding companies and construction and management companies of which The R.E. Group is the parent, which together own and manage approximately sixty multi-family and commercial buildings in Manhattan, comprised of almost 1,400 units and 100,000 square feet of commercial space and which are focused on further commercial development. Mr. Kessner holds a B.S. in Economics from Dartmouth College.

Executive Officers

Information regarding our executive officers may be found under the caption Executive Officers of the Registrant appearing at the end of Part I of our Annual Report on Form 10-K for the year ended December 31, 2006, to which this Form 10-K/A relates. Such information is incorporated herein by reference.

Audit Committee

We have a separately designated standing Audit Committee established in accordance with Section 3(a)(58)(A) of the Exchange Act. The members of the Audit Committee for 2006 were Messrs. Cooper, Weisberg and Hatamiya and Jessie J. Knight, Jr., who resigned from our Board of Directors in December 2006. The current members of the Audit Committee are Messrs. Cooper, Weisberg and Hatamiya. Mr. Cooper serves as chair of the Audit Committee.

Audit Committee Financial Expert

The Board of Directors has determined that John R. Cooper is, and has designated Mr. Cooper as, the Audit Committee Financial Expert as defined by Item 407(d)(5)(ii) of Regulation S-K of the Exchange Act and determined that he is independent within the meaning of Item 407(a) of Regulation S-K of the Exchange Act.

Director Nominees

The process followed by the Nominating and Corporate Governance Committee to identify and evaluate director candidates includes requests to Board members and others for recommendations, meetings from time to time to evaluate biographical information and background material relating to potential candidates and interviews of selected candidates by members of the Committee and the Board of Directors.

In considering whether to recommend any particular candidate for inclusion in the Board of Director s slate of recommended director nominees, the Nominating and Corporate Governance Committee applies certain criteria, including:

- the candidate s honesty, integrity and commitment to high ethical standards;
- demonstrated financial and business expertise and experience;

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- understanding of our company, its business and its industry;
- actual or potential conflicts of interest; and
- the ability to act in the interests of all stockholders.

The Nominating and Corporate Governance Committee does not assign specific weights to particular criteria and no particular criterion is a prerequisite for each prospective nominee. We believe that the backgrounds and qualifications of our directors, considered as a group, should provide a significant breadth of experience, knowledge and abilities that will allow our Board of Directors to fulfill its responsibilities.

The Nominating and Corporate Governance Committee will consider director candidates recommended by stockholders or groups of stockholders who have owned more than 5% of our common stock for at least a year as of the date the recommendation is made. Stockholders may recommend individuals to the Nominating and Corporate Governance Committee for consideration as potential director candidates by submitting their names, together with appropriate biographical information and background materials and a statement as to whether the stockholder or group of stockholders making the recommendation has beneficially owned more than 5% of our common stock for at least a year as of the date such recommendation is made, to the Nominating and Corporate Governance Committee, c/o Corporate Secretary, Environmental Power Corporation, One Cate Street, 4th Floor, Portsmouth, New Hampshire 03801. Assuming that appropriate biographical and background material has been provided on a timely basis, the Committee will evaluate stockholder-recommended candidates by following substantially the same process, and applying substantially the same criteria, as it follows for candidates submitted by others. We will generally consider stockholder nominations for a given year s annual meeting of stockholders to be timely if they are received no later than 120 days before the day of the year that the proxy statement relating to the prior year s annual meeting of stockholders is dated or, in the event the date of the annual meeting in question changes by more than 30 days from the day of the year on which the prior year s annual meeting is held, a reasonable time before we print and send our proxy materials for the annual meeting in question.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934 requires our directors, executive officers and the holders of more than 10% of our common stock to file with the SEC initial reports of ownership of our common stock and other equity securities on a Form 3 and reports of changes in such ownership on a Form 4 or Form 5. Officers, directors and 10% stockholders are required by SEC regulations to furnish us with copies of all Section 16(a) forms they file. To our knowledge, based solely upon a review of the copies of such forms furnished to us for the year ended December 31, 2006, and the information provided to us by those persons required to file such reports, no such person failed to file the forms required by Section 16(a) of the Exchange Act on a timely basis, except as follows:

- on May 8, 2006, Lon Hatamiya, a member of our Board of Directors, filed a late Form 4 relating to the grant of a non-statutory stock option on May 3, 2006;
- on May 8, 2006, Robert I. Weisberg, a member of our Board of Directors, filed a late Form 4 relating to the grant of a non-statutory stock option on May 3, 2006; and
- on November 2, 2006, Dennis Haines, our Vice President and General Counsel, filed a late Form 4 relating to the grant of a non-statutory stock option on October 16, 2006.

Code of Ethics

We have adopted a code of business conduct and ethics that applies to our directors, officers (including our principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions) as well as our employees. A copy of our code of business conduct and ethics is available on our website at www.environmentalpower.com under Investor Relations Corporate Governance . We intend to post on our website all disclosures that are required by applicable law, the rules of the Securities and Exchange Commission or Amex listing standards concerning any amendment to, or waiver from, our code of business conduct and ethics.

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ITEM 11. ***EXECUTIVE COMPENSATION***

INFORMATION ABOUT EXECUTIVE AND DIRECTOR COMPENSATION

Compensation Discussion and Analysis

This compensation discussion describes the material elements of compensation for the fiscal year ending December 31, 2006, that was awarded to, earned by, or paid to each of our current and former executive officers identified in the Summary Compensation Table below as our named executive officers, along with an additional executive officer. . This compensation discussion primarily focuses on the last completed fiscal year, but we also describe certain compensation actions taken before or after the last completed fiscal year to enhance the understanding of this disclosure.

The Compensation Committee of our Board of Directors oversees our executive compensation program. In this role, the Compensation Committee reviews and approves, or recommends for approval by the full Board, all compensation decisions relating to our executive officers. The Committee also oversees our stock-based compensation plans and programs.

Objectives and Philosophy of Our Executive Compensation Program

The objective of our executive compensation program is to align the interests of management with the interests of stockholders by tying a substantial portion of overall compensation opportunities provided to executive officers to the achievement of business objectives and individual performance. Our policy is to offer competitive compensation packages that will permit us to attract and retain individuals with superior abilities, and to motivate and reward such individuals on the basis of corporate performance in an appropriate fashion that is in the long-term interests of Environmental Power and its stockholders.

Our company continues to develop. As it does, we expect to develop formal criteria and programs to reward executive officers based upon an assessment of corporate, business-unit and individual performance. We expect to evaluate corporate- and unit-performance by reviewing the extent to which strategic and business-plan goals are met, including such factors as maintaining capital and operating budgets and timely accomplishment of business-development objectives, as applicable. We expect to evaluate individual performance by reviewing attainment of specified personal objectives and the degree to which teamwork and our other values are fostered.

Comparative Compensation Review Process and Benchmarking

We do not believe that compensation levels should be controlled by benchmarking. However, we believe that information regarding pay practices at other companies is useful in two respects. First, our compensation practices need to be competitive in the marketplace. Second, marketplace information is one of the many factors that we consider in assessing the reasonableness of compensation. Accordingly, from time to time we compare our compensation packages including levels, components, and mix with those of other companies in the alternative energy industry, through reviews of survey data and information gleaned from filings of publicly traded companies and through information compiled and analyzed by others.

While such information may be a useful guide for comparative purposes, we believe that a successful compensation program also requires the application of judgment and subjective determinations of individual performance. Review of this information and these factors forms the basis of management s compensation recommendations to the Compensation Committee and the Committee s decision-making.

Use of Consultants

The Compensation Committee s charter grants it the authority to retain outside advisors, including compensation consultants, and approve their compensation. Environmental Power is obligated to pay the

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Compensation Committee s advisors and consultants. Although management is involved in coordinating with these advisors with respect to the provision of their services, these advisors and consultants report directly to the Compensation Committee.

In June 2004, we undertook a comprehensive review of our compensation policies. At the request of the Compensation Committee, Effective Pay Practices, an outside compensation consulting firm, was hired to review our compensation practices in light of the industry in which we operate, as well as its current stage of development. Effective Pay Practices review supported the position that the compensation of our top executives was generally in line with that of persons with similar roles in similarly situated companies. However, the review also indicated that our employees generally ought to receive further equity incentives in the form of stock options, as well as certain adjustments in their base salaries. As a result certain stock-option grants were made and certain salary adjustments were implemented.

The Compensation Committee revisited these recommendations in the fall of 2005 in connection with its consideration of additional equity incentives to employees generally. Given our stage of development and the cash requirements of our business plan, the Compensation Committee did not recommend any increases in the cash compensation of our top executives in 2005.

We made option grants in 2006 exclusively to new-hires, including the Chief Executive Officer and General Counsel. The Compensation Committee did not engage any outside advisors to assist with those grants or any other compensation-related programs.

In the first quarter of 2007, the Compensation Committee and management began to examine what actions could be taken generally to reduce the impact of possible future stock-option exercises, in terms of dilution and in view of the limited trading volume in our common stock. In this regard, the Compensation Committee, in March 2007, sought the advice of outside counsel and also engaged Brian Foley & Company, Inc., an independent executive compensation consulting firm, to advise the Committee on certain matters relating to stock-based compensation. These matters included the possible use, in connection with future grants, of stock appreciation rights and the possible settlement, subject to the advice of tax and legal counsel, of certain existing stock options, if and when exercised, on a net share basis. The review of these initiatives is ongoing.*

Elements of Executive Compensation

Compensation for our executives generally consists of the following elements:

- base salary;
- bonuses;
- stock-based awards;
- health, dental, life and disability insurance and other traditional employee benefits; and
- severance and change-in-control arrangements.

We have not had any policy or target for allocating compensation between long-term and short-term compensation, between cash and non-cash compensation or among the different forms of non-cash compensation. Instead, the Compensation Committee, with input as requested from senior management, determines subjectively what it believes to be the appropriate level and mix of the various compensation components. Ultimately, the Compensation Committee s objective in allocating between annual and long-term compensation opportunities is to ensure adequate base compensation to attract and retain personnel, while providing incentives to maximize long-term value for our Company and its stockholders. Therefore, we provide

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* An option holder who settles in-the-money options on a net-share basis would receive shares of our common stock equal to the difference between the market value of the shares subject to the option and their exercise price, less required withholding for taxes. An in-the-money stock-appreciation right similarly is settled through issuance of shares, or cash, reflecting the extent of the increase in stock price. Both devices are intended to reduce the dilutive effect to

existing stockholders that results from an exercise of an option.

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cash compensation in the form of base salary to meet estimated competitive salary norms and, to the extent our cash position permits, expect to reward superior performance on an annual basis in the form of bonus compensation. We provide non-cash compensation, principally in the form of equity-based grants such as stock options, that are intended to create incentives for the achievement both of specific objectives and/or long-term strategic goals.

Base Salary. Salary for our executives is generally set by reviewing compensation levels for comparable positions in the market, as described above, and the historical compensation levels of our executives. Salaries may then be adjusted from time to time, based upon market changes, actual corporate and individual performance and promotions or changes in responsibilities. Base salaries and other elements of compensation may also be mandated by the terms of employment and other agreements entered into with our executives, as described under Information about Executive and Director Compensation Employment, Transition, Retirement, Consulting and Severance Agreements. In such cases, base salaries have been determined by arms-length negotiations with these executives, either in connection with their initial hiring or in connection with the retention of such executives and/or their transition to retirement or other roles with our Company.

Bonuses. Bonuses, as well as any annual increases in salaries, are expected to be based on actual corporate and individual performance compared to targeted performance criteria and various subjective performance criteria. Given what we believe are competitive base salaries, as well as our stage of development and cash position, we generally have not paid cash bonuses to our top executives over the last four years. Going forward, as our company develops, the Compensation Committee expects to work with our President and Chief Executive Officer to develop appropriate corporate and individual performance goals that can be reasonably achieved with an appropriate level of effort over the course of the year. We would expect targeted performance criteria to vary for each executive based on areas of responsibility and on the executive s leadership. In considering bonuses in the future, the Compensation Committee does not expect to rely on a formula that assigns a pre-determined value to each of the criteria, but instead expects to evaluate each executive officer s contribution in light of all relevant criteria and taking into account our future cash position.

Stock-Based Awards. Compensation for executive officers also includes the long-term incentives afforded by stock options and other equity-based awards. Our stock option and equity-based award program is designed to align the long-term interests of our employees and our stockholders and assist in the retention of executives. The size of stock-based awards is generally intended to reflect the executive s position and the executive s expected contributions. In 2006 we generally made stock-based awards in connection with the hiring of executives, including the Chief Executive Officer and the General Counsel. In the future, we expect to consider making awards on an annual basis in connection with our annual reviews of executive performance and compensation, as well as in connection with appropriate events, such as the promotion of the executive. The Compensation Committee expects to take into account the value of stock-based awards or other long-term compensation arrangements previously granted or entered into with the executive in making grants of stock-based awards. The value represented by previous awards, however, will not necessarily cause the Committee to forego making, or reduce the size of, a future award. We generally grant stock-based awards with installment-vesting (over a period of up to four years) but also consider possible cliff-vesting, where the grant vests all at once after a specified period, and performance-vesting in appropriate situations.

Because of the direct relationship between the value of an option and the market price of our common stock, we believe that stock options are an effective method of motivating the executive officers to manage our Company in a manner that is consistent with the interests of our Company and our stockholders. However, because of the evolution of regulatory, tax and accounting treatment of equity incentive programs, as well as the low trading volume our common stock has historically experienced, and because it is important to us to retain our executive officers and key employees, it is important that we utilize other forms of equity awards as and when we may deem necessary. We have begun utilizing stock appreciation rights with our employees and in the future expect to utilize them, stock option settlement on a net-share basis, and/or restricted stock awards. By doing so, we hope to achieve the same motivational and compensatory benefits associated with stock options while issuing fewer shares of our common stock.

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Insurance and Other Employee Benefits. We maintain broad-based benefits and perquisites that are provided to all employees, including health insurance, life and disability insurance, dental insurance and a 401(k) plan. Under our 401(k) plan, so long as the employee is employed through the last day of the year in question, we generally make a matching 401(k) contribution of 50% of the employee s contribution, up to 6% of the employee s salary for the year, with a maximum matching contribution of $7,500.

Severance and Change-in-Control Arrangements. Compensation for executive officers also includes severance and change-in-control arrangements, which are generally reflected in the employment agreements for such officers. These arrangements, like other elements of executive compensation, are structured with regard to practices at comparable companies for similarly-situated officers and in a manner we believe is likely to attract and retain high quality executive talent. Changes to existing severance arrangements are also sometimes negotiated with departing executives in exchange for transition services and/or general releases. The severance and change-in-control arrangements currently in place with our current executive officers, and the severance arrangements entered into with executive officers who departed in 2006, are described in greater detail under Employment, Transition, Retirement, Consulting and Severance Arrangements, Summary of Potential Payments Upon Termination or Change of Control and Summary of Actual Payments Upon Retirement or Termination of Employment.

Other Corporate Policies Relating to Executive Compensation

Role of Executive Officers in Determining or Recommending Executive and Director Compensation. Management plays an important role in support of the Compensation Committee s determination of executive compensation. The most significant aspects of management s role are:

- evaluating key-employee performance;
- recommending business performance targets and objectives; and
- recommending salary levels and stock-based awards.

Our President and Chief Executive Officer assists the chair of the Compensation Committee in establishing the agenda for Committee meetings. Management also prepares meeting information for each Compensation Committee meeting. At the Committee s request, our President and Chief Executive Officer also participates in Compensation Committee meetings to provide input if and as sought by the Committee, including but not limited to:

- background information regarding our strategic objectives and progress toward the attainment of those objectives;
- information on the performance of the senior executive officers; and
- compensation recommendations as to senior executive officers other than the Chief Executive Officer.

Ultimately, however, all compensation decisions are made, or recommended to the Board of Directors, by the Compensation Committee, which makes such decisions and recommendations after considering management s recommendations, available market data, and input from outside advisors to the Committee. In doing so the Committee engages in deliberations in executive session without the presence of the Chief Executive Officer or any other members of management.

Management does not play any role in setting non-employee director compensation. Decisions with respect to non-employee director compensation are made by the Compensation Committee based upon a review data from SEC filings and other sources.

Impact of Tax Treatment on Compensation Decisions. Section 162(m) of the Internal Revenue Code of 1986, as amended, generally disallows a tax deduction for compensation in excess of $1.0 million paid to our chief executive officer and our four other most highly paid executive officers. Qualifying performance-based

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compensation is not subject to the deduction limitation if specified requirements are met. We periodically review the potential consequences of Section 162(m) and generally intend to structure our executive compensation to comply with Section 162(m). However, the Compensation Committee may, in its judgment, authorize compensation payments that do not comply with the exemptions in Section 162(m) when it believes that such payments are appropriate to attract and retain executive talent.

Security Ownership Requirements or Guidelines. While we believe it is important for our executives to have an equity stake in our Company in order to help align their interests with those of our stockholders, we do not currently have any equity ownership guidelines for our executive officers.

Discussion of Specific Compensation Arrangements Entered into in 2006

In 2006, with the exception of John O Neill, our Chief Financial Officer, compensation for our top executives was determined largely through negotiations with such executives in connection with the hiring of such executives or their transition to new roles, as described in more detail below. No changes were made with respect to Mr. O Neill s compensation in 2006.

In July 2006, we hired Richard E. Kessel to take over Kamlesh R. Tejwani s responsibilities as our President and Chief Executive Officer. Mr. Kessel s base salary was set at $300,000, as compared to Mr. Tejwani s base salary of $225,000, and he was granted options to purchase 400,000 shares of our common stock, as compared to the grant to Mr. Tejwani of options to purchase 571,429. The terms of Mr. Kessel s employment arrangements are set forth in greater detail under the heading Information About Executive and Director Compensation Employment, Transition, Retirement, Consulting and Severance Arrangements. While Mr. Kessel s employment terms resulted from arms-length negotiations with him, we conducted these negotiations in light of compensation arrangements for chief executives of similarly situated companies, gained through personal experience and informal inquiry. As a result, we believe that Mr. Kessel s salary and equity compensation were set at a level commensurate with his extensive experience, with the responsibility associated with being the President and Chief Executive Officer of our Company and with the compensation afforded to executives fulfilling similar functions at similarly situated companies. We also believe that Mr. Kessel s other employment terms are also appropriate given his experience and responsibilities as well as the terms of employment of other chief executives of similarly situated companies.

In July 2006, we entered into transition and consulting agreements with Messrs. Tejwani, Cresci and Livingston. At the time that these arrangements were entered into, our Company was engaged in several critical initiatives, including an effort to raise equity financing, an effort to raise tax-exempt bond financing for our subsidiary, Microgy, and an effort to build out the first of our facilities in Texas. We believe that it was necessary to retain access to Mr. Tejwani s expertise with respect to the capital markets and his relationships in that field in order to complete our equity financing successfully, which was, in fact, completed in November 2006. Mr. Cresci had taken the lead on, and was deeply involved in, the tax-exempt bond financing in Texas, which was also successfully completed in November 2006. Similarly, Mr. Livingston had been tasked with the build out of the Huckabay Ridge facility in Texas, and the conclusion of agreements relating to our other proposed Texas facilities, efforts on which the success of the Texas bond financing would depend. As a result of our need to retain the services of these individuals past what would have otherwise been their separation or retirement dates, we entered into the Transition Agreement with Mr. Tejwani and the Consulting Agreements with Messrs. Cresci and Livingston described under the heading Employment, Transition, Consulting, Retirement and Severance Arrangements. In addition, Mr. Cresci continued to lead the Texas bond financing effort past the September 30, 2006 expiration date of his Consulting Agreement, and to play a significant role in our federal legislative initiatives over the remainder of 2006. For these efforts, we entered into the additional letter agreement with Mr. Cresci which is also described under the heading Employment, Transition, Consulting, Retirement and Severance Arrangements.

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With respect to Mr. Tejwani s Transition Agreement, his rate of compensation was a continuation of his then current base salary, and we believe that the separation benefits provided to him were consistent with those typically afforded outgoing chief executives of similarly situated companies, particularly those departing on good terms. With respect to Messrs. Cresci and Livingston, their rates of compensation were negotiated with them. As both individuals had served well beyond their originally anticipated retirement dates of December 31, 2005, and had agreed to significant reductions in their base salaries in 2004, it was necessary to increase their rates of compensation over that which they had been receiving prior to their June 30, 2006 retirement dates. Messrs. Cresci and Livingston continued to be treated as employees, but not executive officers, during the term of their respective agreements.

In October 2006, we extended an offer letter to Dennis Haines in connection with his hiring as our Vice President and General Counsel. We believe that the terms of Mr. Haines employment are comparable to those of executives in like positions with similarly situated companies and commensurate with his responsibilities and extensive level of corporate, commercial and administrative experience.

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Executive Compensation

Summary Compensation

The following table sets forth information for the fiscal year ended December 31, 2006 regarding the compensation of our Chairman, our President and Chief Executive Officer, our Chief Financial Officer, our former President and Chief Executive Officer and two additional former executive officers who would have been among our most highly compensated executive officers if they had been serving as executive officers on December 31, 2006. We refer to these individuals as our named executive officers. In addition, we have elected to provide information regarding the compensation of Dennis Haines, our Vice President and General Counsel, even though he served for only a portion of the fourth quarter of 2006 and therefore earned total compensation less than $100,000. We refer to Mr. Haines as the additional executive officer.

SUMMARY COMPENSATION TABLE

Name and Principal Position	Year	Salary	Bonus(1)	Stock Awards(2)	Option Awards(3)	Non-Equity Incentive Plan Compensation(4)	Change in Pension Value and Nonqualified Deferred Compensation Earnings (5)	All Other Compensation(6)	Total
Richard E. Kessel President and Chief Executive Officer and President of Microgy, Inc.	2006	$ 137,500			$ 578,423			$ 6,319	$ 722,242
John F. O Neill Chief Financial Officer and Treasurer	2006	$ 200,000			$ 167,066			$ 31,401	$ 398,467
Dennis Haines Vice President and General Counsel	2006	$ 43,750			$ 20,058			$ 3,661	$ 67,469
Kamlesh R. Tejwani(7) Vice Chairman and former President and Chief Executive Officer	2006	$ 225,000						$ 66,138	$ 291,138
Joseph E. Cresci(8) Chairman	2006	$ 210,375						$ 1,644,026	$ 1,854,401
Donald A. Livingston Former Executive Vice President and President of Microgy, Inc.(9)	2006	$ 225,000						$ 1,565,095	$ 1,790,095
Randall L. Hull Former President of Microgy, Inc.(10)	2006	$ 41,666						$ 112,140	$ 153,806

(1) We did not pay any bonuses in 2006.
(2) We did not make any awards of stock in 2006.
(3) The amounts in the Option Awards column reflect the dollar amounts recognized as compensation expense for financial statement reporting purposes for stock options for the fiscal year ended December 31, 2006 in accordance with SFAS 123(R), using a Black-Scholes option-pricing model

employing certain variables and related assumptions, including stock price volatility. The amounts shown in this column are, therefore, projections that do not necessarily reflect the actual cash compensation to be received by the option holder upon exercise of the option. The assumptions we used to calculate these amounts are discussed in Note I to our consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2006.

(4) We did not pay any non-equity incentive plan compensation in 2006.

(5) We no longer maintain a pension plan, nor do we maintain any nonqualified deferred compensation plans.

(6) The amounts in the All Other Compensation column represent the following amounts for the following individuals:

Richard E. Kessel Life insurance premium: $6,319. Mr. Kessel is entitled to (a) up to $1,000 a month in reimbursement for automobile lease payments, (b) reimbursement for automobile insurance, and (c) coverage under our medical and dental insurance policies. Mr. Kessel did not take any of these benefits in 2006.

John F. O Neill Automobile lease payments: $7,296; Automobile insurance premiums: $1,580; 401(k) match: $7,500; Medical insurance premiums: $13,075; Dental insurance premiums: $1,914; Life insurance premiums: $36

Dennis Haines Automobile expense reimbursement: $2,250; Medical insurance premiums: $774; Dental insurance premiums: $92; Life insurance premiums: $545

Kamlesh R. Tejwani Automobile lease payments: $9,084; Automobile insurance premiums: $3,414; Payout upon termination of pension plan: $40,939; Medical insurance premiums: $10,751; Dental insurance premiums: $1,914; Life insurance premiums: $36

Joseph E. Cresci Automobile lease payments: $11,740; Automobile insurance premiums: $2,424; Consulting fees: $221,666; Payout upon termination of pension plan: $1,395,300; Medical insurance premiums: $11,784; Dental insurance premiums: $1,076; Life insurance premiums: $36

Donald A. Livingston Auto Lease: $12,840; Automobile insurance premiums: $2,893; Consulting fees: $250,000; Payout upon termination of pension plan: $1,292,840; Medical insurance premiums: $5,928; Dental insurance premiums: $558; Life insurance premiums: $36

Randall L. Hull Severance Payment: $100,000; Unused Vacation: $8,462; Medical insurance premiums: $3,216; Dental Insurance: $447; Life insurance premiums: $15

(7) Mr. Tejwani stepped down as our President and Chief Executive Officer in July 2006. Mr. Tejwani remains a director of Environmental Power and serves as Vice Chairman of our Board of Directors in a non-executive capacity.

(8) Mr. Cresci ceased to be an executive officer in July 2006, but remained as an employee through September 30, 2006, after which he served as a consultant through December 31, 2006. Mr. Cresci remains a director of Environmental Power and serves as Chairman of our Board of Directors in a non-executive capacity. Compensation for Mr. Cresci does not reflect $225,000 in accrued severance payments which he is to receive during in the second half of 2007.

(9) Mr. Livingston ceased to be an executive officer in July 2006, but remained as an employee through December 31, 2006. Mr. Livingston resigned from our Board of Directors in January 2007 in connection with his retirement from Environmental Power. Compensation for Mr. Livingston does not reflect $225,000 in accrued severance payments which he is to receive during the second half of 2007.

(10) Mr. Hull s employment with Microgy, Inc. was terminated in March 2006.

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The following table sets forth information regarding each grant of an award made to a named executive officer and the additional executive officer during the fiscal year ended December 31, 2006 under any plan, contract, authorization or arrangement pursuant to which cash, securities, similar instruments or other property may be received.

GRANTS OF PLAN-BASED AWARDS

			Estimated Future Payouts Under Non-Equity Incentive Plan Awards			Estimated Future Payouts Under Equity Incentive Plan Awards						
Name	**Grant Date**	**Date of Corporate Action**	**Threshold**	**Target**	**Maximum**	**Threshold**	**Target**	**Maximum**	**All Other Stock Awards; Number of Shares of Stock or Units**	**All Other Option Awards; Number of Securities Underlying Options**	**Exercise or Base Price of Option Awards ($/sh)**	**Grant Date Fair Value of Stock and Option Awards(1)**
Richard E. Kessel	7/17/06	7/17/06								250,000	$ 6.30	$ 979,151
	7/17/06	7/17/06								150,000	$ 6.30	$ 774,000
John F. O Neill												
Dennis Haines	10/9/06	10/16/06								100,000	$ 5.05	$ 332,081
Kamlesh R. Tejwani												
Joseph E. Cresci												
Donald A. Livingston												
Randall L. Hull												

(1) The amounts in the Grant Date Fair Value of Stock and Option Awards column reflect the grant date fair value of each equity award calculated in accordance with SFAS 123(R), using a Black-Scholes option-pricing model employing certain variables and related assumptions, including stock price volatility. The amounts shown in this column are, therefore, projections that do not necessarily reflect the actual cash compensation to be received by the option holder upon exercise of the option. The assumptions we used to calculate these amounts are discussed in Note I to our consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2006.

Employment, Transition, Retirement, Consulting and Severance Arrangements

Employment Agreement with Richard E. Kessel

On July 12, 2006, we entered into an employment agreement with Richard E. Kessel. Mr. Kessel s employment agreement provides for the following principal terms:

Employment as the our President and Chief Executive Officer commencing on July 17, 2006, referred to as the commencement date, and appointment to the our Board of Directors promptly following the satisfaction of any applicable board independence and composition requirements.

An initial annual salary of $300,000, subject to annual adjustment by the Compensation Committee of our Board of Directors.

The grant of non-qualified stock options to purchase up to 400,000 shares of our common stock, as described below.

Eligibility to participate on the same basis as other executives reporting directly to our chief executive officer in any bonus plan adopted by us from time to time, subject to the terms of any such plan; and