

UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q /A

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

For the quarterly period ended June 30, 2009  
or

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 0-29185

SAVE THE WORLD AIR, INC.

*(Exact name of registrant as specified in its charter)*

Nevada  
*(State or other jurisdiction of  
incorporation or organization)*

52-2088326  
*(I.R.S. Employer  
Identification No.)*

235 Tennant Avenue  
Morgan Hill, California 95037  
*(Address, including zip code, of principal executive offices  
(408) 778-0101  
(Registrant's telephone number, including area code)*

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

Securities registered pursuant to Section 12(g) of the Exchange Act: Common Stock, \$0.001 par value.

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

Indicate by check mark whether the registrant 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.

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

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

The number of shares of the Registrant's Common Stock outstanding as of August 11, 2009 was 65,676,057 shares.

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**SAVE THE WORLD AIR, INC.**  
FORM 10-Q  
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**PART I**

**Item 1. Financial Statements**

**SAVE THE WORLD AIR, INC. AND SUBSIDIARY  
(A DEVELOPMENT STAGE ENTERPRISE)**

**CONDENSED CONSOLIDATED BALANCE SHEETS**

	<b>June 30, 2009</b>	<b>December 31, 2008</b>
	<u>(unaudited)</u>	<u>2008</u>
<b>ASSETS</b>		
<b>Current assets</b>		
Cash	\$ 5,195	\$ 59,346
Other current assets	23,047	33,275
Total current assets	28,242	92,621
<b>Property and Equipment, net of accumulated depreciation and amortization</b> of \$127,969 and \$111,193, respectively	115,193	131,969
<b>Other assets</b>	11,020	11,250
<b>Total assets</b>	<u>\$ 154,455</u>	<u>\$ 235,840</u>
<b>LIABILITIES AND STOCKHOLDERS' DEFICIENCY</b>		
<b>Current liabilities</b>		
Accounts payable-related parties	\$ 156,227	\$ 93,003
Accounts payable-License Agreements	840,750	716,500
Accounts payable-other	501,310	384,467
Accrued expenses	1,022,976	803,795
Accrued professional fees	431,242	390,535
Loans payable-related parties and shareholders	162,341	78,280
Convertible debentures, net-related parties	39,782	12,466
Convertible debentures, net-others	847,253	290,659
Total current liabilities	<u>4,001,881</u>	<u>2,769,705</u>
<b>Commitments and contingencies</b>		
<b>Stockholders' deficiency</b>		
Common stock, \$.001 par value: 200,000,000 shares authorized, 65,508,160 and 62,940,891 shares issued and outstanding at June 30, 2009 and December 31, 2008, respectively	65,508	62,941
Common stock to be issued (99,200 shares at June 30, 2009 and 97,059 shares at December 31, 2008 respectively)	33,750	16,500
Additional paid-in capital	41,328,142	40,129,758
Deficit accumulated during the development stage	(45,274,826)	(42,743,064)
Total stockholders' deficiency	<u>(3,847,426)</u>	<u>(2,533,865)</u>
<b>Total liabilities and stockholders' deficiency</b>	<u>\$ 154,455</u>	<u>\$ 235,840</u>

See notes to condensed consolidated financial statements.

**SAVE THE WORLD AIR, INC. AND SUBSIDIARY**  
**(A DEVELOPMENT STAGE ENTERPRISE)**

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)**

	<u>Three months ended</u>		<u>Six months ended</u>		<b>For the Period From February 18, 1998 (Date of Inception) through June 30, 2009</b>
	<u>June 30,</u>		<u>June 30,</u>		
	<u>2009</u>	<u>2008</u>	<u>2009</u>	<u>2008</u>	
<b>Net sales</b>	\$ -	\$ -	\$ -	\$ -	\$ 69,000
Cost of goods sold	-	-	-	-	24,120
Gross profit	-	-	-	-	44,880
<b>Operating expenses</b>	594,604	519,860	1,435,422	1,280,002	31,362,362
<b>Research and development expenses</b>	15,220	62,692	262,060	322,362	5,720,653
<b>Non-cash patent settlement costs</b>	-	-	-	-	1,610,066
<b>Loss before other income (expense)</b>	(609,824)	(582,552)	(1,697,482)	(1,602,364)	(38,648,201)
<b>Other income (expense)</b>					
Other income	-	11	-	563	(1,140)
Interest income	-	-	-	2	16,342
Interest expense	(369,720)	(161,556)	(834,280)	(488,559)	(6,788,586)
Loss on sale of equipment	-	-	-	(9,683)	(14,426)
Settlement of debt due Morale/Matthews	-	-	-	(927,903)	(927,903)
Settlement of litigation and debt	-	52,070	-	52,070	1,089,088
<b>Net loss</b>	<u>\$ (979,544)</u>	<u>\$ (692,027)</u>	<u>\$ (2,531,762)</u>	<u>\$ (2,975,874)</u>	<u>\$ (45,274,826)</u>
<b>Net loss per share, basic and diluted</b>	<u>\$ (0.02)</u>	<u>\$ (0.02)</u>	<u>\$ (0.04)</u>	<u>\$ (0.06)</u>	
<b>Weighted average shares outstanding, basic and diluted</b>	<u>65,037,789</u>	<u>44,938,165</u>	<u>64,504,305</u>	<u>46,979,175</u>	

See notes to condensed consolidated financial statements.

**SAVE THE WORLD AIR, INC.**  
**(A DEVELOPMENT STAGE ENTERPRISE)**

**CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIENCY**  
**FROM FEBRUARY 18, 1998 (INCEPTION) TO JUNE 30, 2009**

	<u>Price per Share</u>	<u>Common Stock</u>		<u>Common Stock to be Issued</u>	<u>Additional Paid-in Capital</u>	<u>Deferred Compensation</u>	<u>Deficit Accumulated During the Development Stage</u>	<u>Total Stockholders' Deficiency</u>
		<u>Shares</u>	<u>Amount</u>					
<b>Balance, February 18, 1998</b> (date of inception)		—	\$ —	—	\$ —	—	\$ —	\$ —
Issuance of common stock on April 18, 1998	.0015 - .01	10,030,000	10,030	—	14,270	—	—	24,300
Net loss		—	—	—	—	—	(21,307)	(21,307)
<b>Balance, December 31, 1998</b>		10,030,000	\$ 10,030	\$ —	14,270	\$ —	(21,307)	\$ 2,993
Issuance of common stock on May 18, 1999	1.00 - 6.40	198,003	198	—	516,738	—	—	516,936
Issuance of common stock for ZEFS on September 14, 1999	.001	5,000,000	5,000	—	—	—	—	5,000
Stock issued for professional services on May 18, 1999	0.88	69,122	69	—	49,444	—	—	49,513
Net loss		—	—	—	—	—	(1,075,264)	(1,075,264)
<b>Balance, December 31, 1999</b>		<u>15,297,125</u>	<u>\$ 15,297</u>	<u>\$ —</u>	<u>\$ 580,452</u>	<u>\$ —</u>	<u>\$ (1,096,571)</u>	<u>\$ (500,822)</u>

(continued)

SAVE THE WORLD AIR, INC.  
(A DEVELOPMENT STAGE ENTERPRISE)

**CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIENCY  
FROM FEBRUARY 18, 1998 (INCEPTION) TO JUNE 30, 2009**

	Price per Share	Common Stock		Common Stock to be Issued	Additional Paid-in Capital	Deferred Compensation	Deficit Accumulated During the Development Stage	Total Stockholders' Deficiency
	Share	Shares	Amount	Issued	Capital	Compensation	Stage	Deficiency
<b>Balance, December 31, 1999</b>		15,297,125	\$ 15,297	\$ —	\$ 580,452	\$ —	\$ (1,096,571)	\$ (500,822)
Issuance of common stock for services	\$0.38 - \$5.31	305,810	306	—	588,704	—	—	589,010
Stock issued for employee compensation on February 8, 2000	\$1.03-\$5.31	42,000	42	—	137,378	—	—	137,420
Stock issued for directors fees	\$3.38-\$4.44	56,000	56	—	195,584	—	—	195,640
Common stock cancelled		(55,000)	(55)		(64,245)			(64,300)
Net loss		—	—	—	—	—	(1,270,762)	(1,270,762)
<b>Balance, December 31, 2000</b>		15,645,935	15,646	—	1,437,873	—	(2,367,333)	(913,814)
Issuance of common stock for services	\$0.25-\$1.65	1,339,912	1,340	—	1,031,231	—	—	1,032,571
Stock issued for directors fees	\$0.60-\$0.95	1,100,000	1,100		1,008,900			1,010,000
Intrinsic value of options issued to employees					2,600,000	(2,600,000)		—
Fair value of options issued to non- employees					142,318			142,318
Amortization of deferred compensation						191,667		191,667
Net loss							(2,735,013)	(2,735,013)
<b>Balance, December 31, 2001</b>		18,085,847	\$ 18,086	\$ —	\$ 6,220,322	\$ (2,408,333)	\$ (5,102,346)	\$ (1,272,271)

(continued)

**SAVE THE WORLD AIR, INC.**  
**(A DEVELOPMENT STAGE ENTERPRISE)**

**CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIENCY (continued)**  
**FROM FEBRUARY 18, 1998 (INCEPTION) TO JUNE 30, 2009**

	<u>Price per Share</u>	<u>Common Stock</u>		<u>Common Stock to be Issued</u>	<u>Additional Paid-in Capital</u>	<u>Deferred Compensation</u>	<u>Deficit Accumulated During the Development Stage</u>	<u>Total Stockholders' Deficiency</u>
		<u>Shares</u>	<u>Amount</u>					
<b>Balance, December 31, 2001</b>		18,085,847	\$ 18,086	\$ —	\$ 6,220,322	\$ (2,408,333)	\$ (5,102,346)	\$ (1,272,271)
Stock issued for directors fees	0.40	2,150,000	2,150	—	857,850	—	—	860,000
Common stock sold (2,305,000 shares)	0.15- 0.25	—	—	389,875	—	—	—	389,875
Fair value of options issued to non-employees for services		—	—	—	54,909	(54,909)	—	—
Amortization of deferred compensation		—	—	—	—	891,182	—	891,182
Net loss		—	—	—	—	—	(2,749,199)	(2,749,199)
<b>Balance, December 31, 2002</b>		20,235,847	20,236	389,875	7,133,081	(1,572,060)	(7,851,545)	(1,880,413)
Common stock issued previously paid for	0.15- 0.25	2,305,000	2,305	(433,750)	431,445	—	—	—
Sale of common stock	\$ 0.25	9,504,000	9,504	—	2,366,439	—	—	2,375,943
Issuance of common stock for services	\$ 0.55	83,414	83	—	45,794	—	—	45,877
Common stock issued for convertible debt	\$ 0.25	2,000,000	2,000	—	498,000	—	—	500,000
Finders' fees related to stock issuances		—	—	43,875	(312,582)	—	—	(268,707)
Common stock sold (25,000 shares)	0.25	—	—	6,250	—	—	—	6,250
Amortization of deferred comp		—	—	—	—	863,727	—	863,727
Net loss		—	—	—	—	—	(2,476,063)	(2,476,063)
<b>Balance, December 31, 2003</b>		<u>34,128,261</u>	<u>\$ 34,128</u>	<u>\$ 6,250</u>	<u>\$10,162,177</u>	<u>\$ (708,333)</u>	<u>\$ (10,327,608)</u>	<u>\$ (833,386)</u>

(continued)

**SAVE THE WORLD AIR, INC.**  
**(A DEVELOPMENT STAGE ENTERPRISE)**

**CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIENCY (continued)**  
**FROM FEBRUARY 18, 1998 (INCEPTION) TO JUNE 30, 2009**

	<u>Price per Share</u>	<u>Common Stock</u>		<u>Common Stock to be Issued</u>	<u>Additional Paid-in Capital</u>	<u>Deferred Compensation</u>	<u>Deficit Accumulated During the Development Stage</u>	<u>Total Stockholders' Deficiency</u>
		<u>Shares</u>	<u>Amount</u>					
<b>Balance, December 31, 2003</b>		34,128,261	\$ 34,128	\$ 6,250	\$10,162,177	\$ (708,333)	\$ (10,327,608)	\$ (833,386)
Common stock issued previously paid for	\$ .25	25,000	25	(6,250)	6,225			—
Sale of common stock	\$ 1.00	1,272,500	1,273	119,000	1,271,227	—	—	1,391,500
Stock issued for services	\$ .15-\$1.70	1,268,560	1,268		1,388,663			1,389,931
Stock issued for directors fees	\$ 1.50	50,000	50	—	74,950	—	—	75,000
Common stock issued for convertible debt	\$ 1.53	60,000	60		91,740	—	—	91,800
Common stock issued upon exercise of warrants and options	\$ .20 -\$.40	960,500	960	—	193,240	—	—	194,200
Common stock issued for patent settlement	\$ 1.24	20,000	20		24,780			24,800
Fair value of warrants issued					1,614,138			1,614,138
Fair value of options issued to employees		—	—	—	248,891	(248,891)	—	—
Fair value of options issued to non-employees		—	—	—	55,381	(55,381)	—	—
Amortization of deferred compensation		—	—	—	—	936,537	—	936,537
Finders' fees related to stock issuances					(88,384)			
Net loss		—	—	—	—	—	(6,803,280)	(6,803,280)
<b>Balance, December 31, 2004</b>		<u>37,784,821</u>	<u>\$ 37,784</u>	<u>\$ 119,000</u>	<u>\$15,043,028</u>	<u>\$ (76,068)</u>	<u>\$ (17,130,888)</u>	<u>\$ (2,007,144)</u>

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**SAVE THE WORLD AIR, INC.**  
**(A DEVELOPMENT STAGE ENTERPRISE)**

**CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIENCY (continued)**  
**FROM FEBRUARY 18, 1998 (INCEPTION) TO JUNE 30, 2009**

	Price per Share	Common Stock		Common Stock to be Issued	Additional Paid-in Capital	Deferred Compensation	Deficit Accumulated During the Development Stage	Total Stockholders' Deficiency
	Share	Shares	Amount	Issued	Capital	Compensation	Stage	Deficiency
<b>Balance, December 31, 2004</b>		37,784,821	\$ 37,784	\$ 119,000	\$15,043,028	\$ (76,068)	\$ (17,130,888)	\$ (2,007,144)
Common stock issued previously paid for	\$1.00	119,000	119	(119,000)	118,881	—	—	—
Sale of common stock	\$1.00	1,530,500	1,530		1,528,970	—	—	1,530,500
Common stock issued upon exercise of warrants	\$1.00	500	1	—	199	—	—	200
Common stock to be issued for settlement of payables				612,521				612,521
Fair value of options issued for settlement costs					31,500			31,500
Fair value of warrants issued					18,462			18,462
Fair value of warrants issued and intrinsic value of beneficial conversion associated with convertible notes					1,453,181			1,453,181
Fair value of options issued to employees		—	—	—	243,750	(243,750)	—	—
Amortization of deferred compensation		—	—	—	—	177,631	—	177,631
Finders' fees related to stock issuances					(109,840)			(109,840)
Common stock cancelled		(8,047,403)	(8,047)		8,047			—
Net loss		—	—	—	—	—	(3,115,186)	(3,115,186)
<b>Balance, December 31, 2005</b>		<u>31,387,418</u>	<u>\$ 31,387</u>	<u>\$ 612,521</u>	<u>\$18,336,178</u>	<u>\$ (142,187)</u>	<u>\$ (20,246,074)</u>	<u>\$ (1,408,175)</u>

(continued)

**SAVE THE WORLD AIR, INC.**  
**(A DEVELOPMENT STAGE ENTERPRISE)**

**CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIENCY (continued)**  
**FROM FEBRUARY 18, 1998 (INCEPTION) TO JUNE 30, 2009**

	<u>Price per Share</u>	<u>Common Stock Shares</u>	<u>Common Stock Amount</u>	<u>Common Stock to be Issued</u>	<u>Additional Paid-in Capital</u>	<u>Deferred Compensation</u>	<u>Deficit Accumulated During the Development Stage</u>	<u>Total Stockholders' Deficiency</u>
<b>Balance, December 31, 2005</b>		31,387,418	\$ 31,387	\$ 612,521	\$ 18,336,178	\$ (142,187)	\$ (20,246,074)	\$ (1,408,175)
Common stock issued previously paid for		846,549	847	(612,521)	611,674	—	—	—
Sale of common stock	\$1.00 - \$1.89	1,360,537	1,360	60,000	2,401,048	—	—	2,462,408
Common stock issued upon exercise of warrants	\$.50 - \$1.50	2,583,533	2,584	—	1,794,944	—	—	1,797,528
Common stock to be issued for convertible debt	\$.70	3,416,186	3,417		2,356,449			2,359,866
Common stock to be issued for out of line of credit	\$.55 - \$1.22	487,483	487		379,610			380,097
Fair value of options issued to employees		—	—	—	2,253,263		—	2,253,263
Fair value of options issued for settlement costs					31,500			31,500
Fair value of warrants issued for services					463,627			463,627
Fair value of warrants issued and intrinsic value of beneficial conversion associated with convertible notes					1,259,696			1,259,696
Write off of deferred compensation		—	—	—	(142,187)	142,187	—	—
Finders' fees related to stock issuances					(284,579)			(284,579)
Fees paid on equity line of credit					(30,402)			(30,402)
Net loss		—	—	—	—	—	(10,181,523)	(10,181,523)
<b>Balance, December 31, 2006</b>		<u>40,081,757</u>	<u>\$ 40,082</u>	<u>\$ 60,000</u>	<u>\$ 29,430,821</u>	<u>\$ —</u>	<u>\$ (30,427,597)</u>	<u>\$ (896,694)</u>

(continued)

**SAVE THE WORLD AIR, INC.**  
**(A DEVELOPMENT STAGE ENTERPRISE)**

**CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIENCY (continued)**  
**FROM FEBRUARY 18, 1998 (INCEPTION) TO JUNE 30, 2009**

	<u>Price per Share</u>	<u>Common Stock</u>		<u>Common Stock to be Issued</u>	<u>Additional Paid-in Capital</u>	<u>Deficit Accumulated During the Development Stage</u>	<u>Total Stockholders' Deficiency</u>
		<u>Shares</u>	<u>Amount</u>				
<b>Balance, December 31, 2006</b>		40,081,757	\$ 40,082	\$ 60,000	\$ 29,430,821	\$ (30,427,597)	\$ (896,694)
Common stock issued previously paid for		2,597,524	2,598	(60,000)	57,402	—	—
Common stock to be issued for convertible debt	\$.17 - \$.53	1,910,711	1,911		524,569		526,480
Common stock issued for put of line of credit	\$.27 - \$.73	1,880,421	1,880		990,175		992,055
Common stock granted for services				4,000			4,000
Fair value of options issued to employees		—	—	—	67,592	—	67,592
Fair value of warrants issued for services					35,340		35,340
Fair value of warrants issued and intrinsic value of beneficial conversion associated with convertible notes					1,253,548		1,253,548
Fees paid on equity line of credit					(79,364)		(79,364)
Net loss		—	—	—	—	(6,262,743)	(6,262,743)
<b>Balance, December 31, 2007</b>		<u>46,470,413</u>	<u>\$ 46,471</u>	<u>\$ 4,000</u>	<u>\$ 32,280,083</u>	<u>\$ (36,690,340)</u>	<u>\$ (4,359,786)</u>

(continued)

**SAVE THE WORLD AIR, INC.**  
**(A DEVELOPMENT STAGE ENTERPRISE)**

**CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIENCY (continued)**  
**FROM FEBRUARY 18, 1998 (INCEPTION) TO JUNE 30, 2009**

	Price per Share	Common Stock		Common Stock to be Issued	Additional Paid-in Capital	Deficit Accumulated During the Development Stage	Total Stockholders' Deficiency
		Shares	Amount				
<b>Balance, December 31, 2007</b>		46,470,413	\$ 46,471	\$ 4,000	\$ 32,280,083	\$ (36,690,340)	\$ (4,359,786)
Common stock issued for convertible debt	\$ .17 - \$.53	5,575,082	5,574	16,500	1,936,171	—	1,958,245
Common stock issued for Morale/ Matthews settlement	\$.38	7,421,896	7,422	—	2,776,289	—	2,783,711
Common stock issued for services	\$.17 - \$.49	2,398,850	2,399	—	516,230	—	518,629
Common stock issued upon exercise of warrants	\$.50	1,064,650	1,065	—	531,260	—	532,325
Fair value of options issued as compensations	—	—	—	—	645,745	—	645,745
Fair value of warrants issued and intrinsic value of beneficial conversion associated with convertible notes	—	—	—	—	1,323,077	—	1,323,077
Fair value of warrants issued to PIPE holders	—	—	—	—	116,913	—	116,913
Common stock issued for services	0.17	10,000	10	(4,000)	3,990	—	—
Net loss	—	—	—	—	—	(6,052,724)	(6,052,724)
<b>Balance, December 31, 2008</b>		<u>62,940,891</u>	<u>\$ 62,941</u>	<u>\$ 16,500</u>	<u>\$ 40,129,758</u>	<u>\$ (42,743,064)</u>	<u>\$ (2,533,865)</u>

(continued)

**SAVE THE WORLD AIR, INC.**  
**(A DEVELOPMENT STAGE ENTERPRISE)**

**CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIENCY (continued)**  
**FROM FEBRUARY 18, 1998 (INCEPTION) TO JUNE 30, 2009**

	<u>Price per Share</u>	<u>Common Stock</u>		<u>Common Stock to be Issued</u>	<u>Additional Paid-in Capital</u>	<u>Deficit Accumulated During the Development Stage</u>	<u>Total Stockholders' Deficiency</u>
		<u>Shares</u>	<u>Amount</u>				
<b>Balance, December 31, 2008</b>		62,940,891	\$ 62,941	\$ 16,500	\$ 40,129,758	\$ (42,743,064)	\$ (2,533,865)
Common stock issued for convertible debt	0.15-0.50	2,014,914	2,015	(16,500)	430,614	—	416,129
Common stock issued for services	0.17-0.49	502,355	502	—	173,911	—	174,413
Common stock issued for settlement of accounts payable	0.27	50,000	50	33,750	13,450	—	47,250
Fair value of options issued as compensation	—	—	—	—	44,498	—	44,498
Fair value of warrants issued for note payable	—	—	—	—	1,248	—	1,248
Fair value of warrants issued and intrinsic value of beneficial conversion associated with convertible notes	—	—	—	—	534,663	—	534,663
Net loss	—	—	—	—	—	(2,531,762)	(2,531,762)
<b>Balance, June 30, 2009 (unaudited)</b>		<u>65,508,160</u>	<u>\$ 65,508</u>	<u>\$ 33,750</u>	<u>41,328,142</u>	<u>\$ (45,274,826)</u>	<u>\$ (3,847,426)</u>

See notes to condensed consolidated financial statements.

**SAVE THE WORLD AIR, INC. AND SUBSIDIARY**  
**(A DEVELOPMENT STAGE ENTERPRISE)**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**

	<u>Six months ended</u>		<b>February 18,</b>
	<u>June 30,</u>	<u>June 30,</u>	<b>1998</b>
	<b>2009</b>	<b>2008</b>	<b>(inception)</b>
			<b>To June 30,</b>
			<b>2009</b>
<b>Cash flows from operating activities</b>			
Net loss	\$ (2,531,762)	\$ (2,975,874)	\$ (45,274,826)
Adjustments to reconcile net loss to net cash used in operating activities:			
Write off of intangible assets	—	—	505,000
Settlement of litigation and debt	—	—	(1,017,208)
Settlement of debt due Morale/Mathews	—	927,903	927,903
Stock based compensation expense	45,746	43,636	3,660,667
Issuance of common stock for services	174,413	51,879	5,378,644
Issuance of options for legal settlement	—	—	31,500
Issuance of warrants for legal settlement	—	—	4,957
Issuance of warrants for financing fees	—	116,913	152,253
Non-cash increase in convertible notes recorded as expense	—	89,470	163,962
Patent acquisition cost	—	—	1,610,066
Addition of Interest Expense to Convertible Note Principal	23,000	—	23,000
Amortization of issuance costs and original issue debt discounts including beneficial conversion feature-part of interest expense	797,457	514,942	6,415,766
Amortization of deferred compensation	—	—	3,060,744
Loss on disposition of assets	—	9,683	14,426
Depreciation and amortization	16,776	19,447	409,905
Bad debt	—	1,380	1,380
Changes in operating assets and liabilities:			
Accounts receivable	—	—	(1,380)
Inventory	—	—	—
Prepaid expenses and other	10,228	(15,870)	(23,047)
Other assets	230	(6,750)	(11,020)
Accounts payable and accrued expenses	610,880	167,869	4,298,491
Net cash used in operating activities	<u>(853,032)</u>	<u>(1,055,372)</u>	<u>(19,668,817)</u>
<b>Cash flows from investing activities</b>			
Purchase of property and equipment	—	(345)	(553,452)
Proceeds from sale of equipment	—	17,477	17,478
Net cash provided by (used in) investing activities	<u>—</u>	<u>17,132</u>	<u>(535,974)</u>
<b>Cash flows from financing activities</b>			
Net proceeds under equity line of credit	—	—	1,262,386
Increase (decrease) in payables to related parties and shareholder	84,061	2,442	694,125
Advances from founding executive officer	—	—	517,208
Net proceeds from issuance of convertible notes and warrants	714,820	534,000	7,175,243
Repayment of convertible notes	—	—	(226,250)
Net proceeds from issuance of common stock	—	532,325	10,787,274
Net cash provided by financing activities	<u>798,881</u>	<u>1,068,767</u>	<u>20,209,986</u>
<b>Net increase (decrease) in cash</b>	<u>(54,151)</u>	<u>30,527</u>	<u>5,195</u>
<b>Cash, beginning of period</b>	<u>59,346</u>	<u>47,660</u>	<u>—</u>
<b>Cash, end of period</b>	<u>\$ 5,195</u>	<u>\$ 78,187</u>	<u>\$ 5,195</u>

(Continued)

**SAVE THE WORLD AIR, INC. AND SUBSIDIARY**  
**(A DEVELOPMENT STAGE ENTERPRISE)**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED) (Continued)**

	<u>Six months ended</u>		<b>February 18,</b>
	<b>June 30,</b>	<b>June 30,</b>	<b>1998</b>
	<b>2009</b>	<b>2008</b>	<b>(inception)</b>
	<u>2009</u>	<u>2008</u>	<u>to</u>
			<b>June 30,</b>
			<b>2009</b>
<b>Supplemental disclosures of cash flow information</b>			
Cash paid during the period for			
Interest	\$ 1,584	\$ 621	\$ 137,983
Income taxes	\$ —	\$ —	\$ 5,882
<b>Non-cash investing and financing activities</b>			
Acquisition of intangible asset through advance from related party and issuance of common stock	\$ —	\$ —	\$ 505,000
Deferred compensation for stock options issued for services	—	—	3,202,931
Purchase of property and equipment financed by advance from related party	—	—	3,550
Conversion of related party debt to equity	—	—	515,000
Issuance of common stock in settlement of payable	47,250	—	147,731
Cancellation of stock	—	—	8,047
Conversion of accounts payable and accrued expenses to common stock issued	—	—	612,521
Conversion of related party debt to convertible debentures	—	—	45,000
Conversion of convertible debentures to common stock	416,129	—	5,347,808
Issuance of shares for settlement of loans and other payable to Morale/Matthews	—	2,783,711	2,783,711
Write off of deferred compensation	—	—	142,187
Non-cash equity-warrant valuation and intrinsic value of beneficial conversion associated with convertible notes	534,663	226,532	5,941,078

See notes to condensed consolidated financial statements.

**SAVE THE WORLD AIR, INC. AND SUBSIDIARY  
(A DEVELOPMENT STAGE ENTERPRISE)**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
SIX MONTHS ENDED JUNE 30, 2009 (UNAUDITED)**

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**1. Organization and basis of presentation**

**Basis of presentation**

The accompanying unaudited condensed consolidated financial statements of Save the World Air, Inc. (the "Company") have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and pursuant to the requirements for reporting on Form 10-Q and Regulation S-K for scaled disclosures for smaller reporting companies. Accordingly, they do not include all the information and footnotes required by accounting principles generally accepted in United States of America for complete financial statements. However, such information reflects all adjustments (consisting solely of normal recurring adjustments), which are, in the opinion of management, necessary for the fair presentation of the consolidated financial position and the consolidated results of operations. Results shown for interim periods are not necessarily indicative of the results to be obtained for a full fiscal year.

The condensed consolidated balance sheet information as of December 31, 2008 was derived from the audited consolidated financial statements included in the Company's Annual Report on Form 10-K filed with the SEC. These interim financial statements should be read in conjunction with that report.

**Going Concern**

Since its inception, the Company has been primarily engaged in organizational and pre-operating activities. The Company has generated insignificant revenues and has incurred accumulated losses of \$45,274,826 from February 18, 1998 (Inception) through June 30, 2009. As reflected in the accompanying condensed consolidated financial statements, the Company had a net loss of \$2,531,762 and a negative cash flow from operations of \$853,032 for the six months ended June 30, 2009, and had a working capital deficiency of \$3,973,639 and a stockholders' deficiency of \$3,847,426 at June 30, 2009. The Company is currently unable to meet its cash obligations and is in default of certain of its convertible note agreements and its obligations under its license agreements with Temple University (see Note 8). As a result, the Company's independent registered public accounting firm, in their report on the Company's 2008 consolidated financial statements, raised substantial doubt about the Company's ability to continue as a going concern.

Our operations to date have been funded through issuances of our common stock and convertible notes whereby we raised an aggregate \$17,962,517 from February 18, 1998 (inception) through June 30, 2009. Based on our current operating plan, we believe that we do not have sufficient cash and cash equivalents to implement our operating plan. We will need to obtain additional financing in addition to the funds already raised through the sale of equity securities to fund our cash needs and continue our operations. Additional financing, whether through public or private equity or debt financing, arrangements with stockholders or other sources to fund operations, may not be available, or if available, may be on terms unacceptable to us. Our ability to maintain sufficient liquidity is dependent on our ability to raise additional capital. If we issue additional equity securities to raise funds, the ownership percentage of our existing stockholders would be reduced. New investors may demand rights, preferences or privileges senior to those of existing holders of our common stock. Debt incurred by us would be senior to equity in the ability of debt holders to make claims on our assets. The terms of any debt issued could impose restrictions on our operations. If adequate funds are not available to satisfy either medium or long-term capital requirements, our operations and liquidity could be materially adversely affected and we could be forced to cut back our operations.

***Description of business***

Save the World Air, Inc. ("STWA") designs, licenses and develops products to increase engine performance, reduce harmful emissions and increase fuel efficiency. The Company is a green technology company that leverages a suite of patented, patent-pending and licensed intellectual properties related to the treatment of fuels. Technologies patented by or licensed to us utilize either magnetic or uniform electrical fields to alter physical characteristics of fuels and are designed to create cleaner combustion. Cleaner combustion has been shown to improve performance, enhance fuel economy and/or reduce harmful emissions in laboratory testing.

The Company has three product lines; MAG ChargR™ and ECO ChargR™, ELEKTRA™ and AOT (Applied Oil Technology). The Company believes development of MAG ChargR is complete and it will be ready to be manufactured by the end of third quarter 2009. We believe the ELEKTRA is nearing the end of the product development cycle which we believe will culminate in an upcoming SAE (Society of Automotive Engineers) test to prove and certify the level of fuel savings. AOT is in the research and development phase.



The Company was incorporated on February 18, 1998, as a Nevada corporation, under the name Mandalay Capital Corporation. The Company changed its name to Save the World Air, Inc. on February 11, 1999, following the acquisition of marketing and manufacturing rights of the ZEFS technologies.

## **2. Summary of significant accounting policies**

### ***Development stage enterprise***

The Company is a development stage enterprise as defined by Statement of Financial Accounting Standards (SFAS) No. 7, "Accounting and Reporting by Development Stage Enterprises." All losses accumulated since the inception of the Company have been considered as part of the Company's development stage activities.

The Company's focus is on product development and marketing of proprietary devices that are designed to reduce harmful emissions, and improve fuel efficiency and engine performance on equipment and vehicles driven by internal combustion engines and has not yet generated meaningful revenues. The technologies are called "ZEFS", "MK IV", "ELEKTRA" and "CAT-MATE". The Company is currently marketing its ECO and MAG ChargR products incorporating ZEFS and MK IV technologies, worldwide; and the Company is in the early stages of developing ELEKTRA products. Expenses have been funded through the sale of company stock, convertible notes and the exercise of warrants. The Company has taken actions to secure the intellectual property rights to the ZEFS, MK IV and CAT-MATE devices and is the worldwide exclusive licensee for patent pending technologies associated with the development of ELEKTRA.

### ***Estimates***

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Certain significant estimates were made in connection with preparing the Company's financial statements. Actual results could differ from those estimates.

### ***Loss per share***

Basic loss per share is computed by dividing net loss available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted loss per share reflects the potential dilution, using the treasury stock method, that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the loss of the Company. In computing diluted loss per share, the treasury stock method assumes that outstanding options and warrants are exercised and the proceeds are used to purchase common stock at the average market price during the period. Options and warrants may have a dilutive effect under the treasury stock method only when the average market price of the common stock during the period exceeds the exercise price of the options and warrants. For the six month periods ended June 30, 2009 and 2008, the dilutive impact of outstanding stock options of 4,551,225 and 1,901,225 respectively, and outstanding warrants of 10,396,328 and 13,319,020 have been excluded because their impact on the loss per share is anti-dilutive.

### ***Stock-based compensation***

The Company periodically issues stock options and warrants to employees and non-employees in non-capital raising transactions for services and for financing costs. The Company adopted SFAS No. 123R, "Share Based Payment", effective February 1, 2006, and is using the modified prospective method in which compensation cost is recognized beginning with the effective date (a) based on the requirements of SFAS No. 123R for all share-based payments granted after the effective date and (b) based on the requirements of SFAS No. 123R for all awards granted to employees prior to the effective date of SFAS No. 123R that remained unvested on the effective date.

The Company accounts for stock option and warrant grants issued and vesting to non-employees in accordance with EITF No. 96-18: "Accounting for Equity Instruments that are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services" and EITF No. 00-18: "Accounting Recognition for Certain Transactions involving Equity Instruments Granted to Other Than Employees" whereas the value of the stock compensation is based upon the measurement date as determined at either a) the date at which a performance commitment is reached, or b) at the date at which the necessary performance to earn the equity instruments is complete.

### ***Fair value of financial instruments***

Fair Value Measurements are determined by the Company's adoption of Statement of Financial Accounting Standards ("SFAS") No. 157, "Fair Value Measurements" ("SFAS 157") as of January 1, 2008, with the exception of the application of the statement to non-recurring, non-financial assets and liabilities as permitted. The adoption of SFAS 157 did not have a material impact on the Company's fair value measurements. SFAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. SFAS 157 establishes a fair value hierarchy, which prioritizes the inputs used in measuring fair value into three broad levels as follows:

Level 1—Quoted prices in active markets for identical assets or liabilities.

Level 2—Inputs, other than the quoted prices in active markets, are observable either directly or indirectly.

Level 3—Unobservable inputs based on the Company's assumptions.

SFAS 157 requires the use of observable market data if such data is available without undue cost and effort

### ***Recent accounting pronouncements***

In December 2007, Financial Accounting Standards Board (FASB) Statement 141R, "Business Combinations (revised 2007)" (SFAS 141R) was issued. SFAS 141R replaces SFAS 141 "Business Combinations". SFAS 141R requires the acquirer of a business to recognize and measure the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree at fair value. SFAS 141R also requires transactions costs related to the business combination to be expensed as incurred. SFAS 141R applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The effective date, as well as the adoption date for the Company was January 1, 2009. Although SFAS 141R may impact our reporting in future financial periods, we have determined that the standard did not have any impact on our historical consolidated financial statements at the time of adoption.

In April 2008 the FASB issued FASB Staff Position ("FSP") No. 142-3, "Determination of the Useful Life of Intangible Assets" ("FSP 142-3"), which amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS 142. This pronouncement requires enhanced disclosures concerning a company's treatment of costs incurred to renew or extend the term of a recognized intangible asset. FST 142-3 is effective for financial statements issued for fiscal years beginning after December 15, 2008. The effective date, as well as the adoption date for the Company was January 1, 2009. Although FSP 142-3 may impact our reporting in future financial periods, we have determined that the standard did not have any impact on our historical consolidated financial statements at the time of adoption.

Other recent accounting pronouncements issued by the FASB (including its Emerging Issues Task Force), the AICPA, and the SEC did not or are not believed by management to have a material impact on the Company's present or future consolidated financial statements.

### **3. Certain relationships and related transactions**

#### ***Loans from related parties and shareholders***

In May 2007, August 2007 and May 2009, a former officer and incumbent director of the Company loaned \$31,404, \$50,000 and \$5,000 to the Company. These amounts are unsecured, bear interest at 6% per annum and are due on demand. At June 30, 2009 and December 31, 2008, the balance of these loans including interest was \$85,447 and 78,280, respectively.

In April 2009, a shareholder loaned \$47,000 to the Company. The loan is unsecured, bears interest at 10% and matured last June 23, 2009, as such, in default. The loan also included the issuance of a warrant to purchase 10,000 shares of the Company's common stock. The warrant is exercisable on a cash basis only at a price of \$0.50 per share, and is exercisable for a period of two years from the date of issuance. The warrant was valued at \$1,248 and was reflected as a financing cost in the accompanying statement of operations. The balance owing at June 30, 2009 including interest was \$47,876.

In April 2009, a shareholder loaned \$25,000 to the Company. The loan is unsecured, bears interest at 10%, per annum and is due on demand. The balance owing at June 30, 2009 including interest was \$25,418.

In June 2009 an officer and director of the Company loaned \$3,600 which amount was outstanding at June 30, 2009.

#### ***Accounts Payable to related parties***

As of June 30, 2009 and December 31, 2008, the Company had accounts payable to related parties in the amount of \$156,227, which was composed of \$109,776 in unpaid Directors Fees and \$46,451 in unreimbursed expenses incurred by Officers and Directors. As of December 31, 2008, the Company had accounts payable to related parties in the amount of \$93,003, which was composed of \$59,705 in unpaid Directors Fees, \$33,298 in unreimbursed expenses incurred by Officers and Directors.

### *Marketing and promotional services agreement with related party*

In July 2006, the Company entered into an agreement with SS Sales and Marketing Group (“SS Sales”), to provide exclusive marketing and promotional services in the western United States and western Canada (the “Territory”) for the Company’s products. The agreement has a term of five years unless sooner terminated by either party on 30 days’ notice. In the event of termination, SS Sales will be entitled to receive all commissions payable through the date of termination. SS Sales is owned by Nathan Shelton, who has served as one of the directors of the Company since February 12, 2007. There were no payments made to SS Sales for the six month periods ending June 30, 2009 and 2008.

#### **4. Loans and other payables due to Morale/Matthews**

Leodis Matthews, through his law firm, Matthews & Partners, (“Matthews”) serves as outside legal counsel to the Company. Morale Orchards, LLC (“Morale”) is owned by Jacqueline Alexander, the wife of Leodis Matthews.

In 2006 and 2007, Morale purchased two convertible promissory notes totaling \$1,225,000. The notes were unsecured, convertible into 1,595,588 shares of common stock, due one year from the date issued, and had an implied interest rate of 22.5%. Warrants to purchase 797,794 shares of common stock were issued with the notes. As of January 31, 2008, the notes were in default, and the total amount due for the notes was \$1,362,212, including penalties and interest. In addition to the two notes, the Company borrowed \$20,000 from Morale on October 30, 2007. At January 31, 2008, the Company was also indebted to Matthews \$472,762 for past legal fee.

Effective January 31, 2008, the Company, Morale, and Matthews agreed to a settlement of the Company’s loans due Morale and fees due Matthews. Morale agreed to waive all accrued interest on the notes after January 31, 2008, and Morale and Matthews agreed to accept 7,421,896 shares of common stock of the Company as payment of the notes payable and fees.

On March 10, 2008, the Company issued 5,530,848 shares of the Company’s common stock valued at \$2,101,722 to Morale for the conversion of the notes (totaling \$1,362,212) and cancellation of \$20,000 Note. Also on March 10, 2008, the Company issued 1,891,048 shares of the Company’s common stock valued at \$718,598 to Matthews in exchange for settlement of the legal fees due Matthews of \$472,762.

The fair value of the shares of common stock issued was determined to be \$0.38 per share, based on the closing price of the Company’s common stock on January 31, 2008, for a total settlement of \$2,820,320. As a result of the issuance of shares of common stock, the Company incurred additional non-cash costs of \$927,903 that have been reflected as costs to settle outstanding debt in the accompanying condensed consolidated statement of operations for the six months ended June 30, 2008.

#### **5. Convertible Debentures**

Convertible debentures consist of the following:

	<u>Maturity dates</u>	<u>June 30, 2009</u>	<u>December 31, 2008</u>
2007 Winter Offering	February 29, 2009	\$ —	\$ 66,000
2008 Summer Offering	August 31, 2009	341,000	341,000
2008 Fall Offering	October 31, 2009	127,820	152,020
2008 Winter Offering	December 5, 2009	117,700	337,700
2009 Winter Offering – I	April 26, 2009	253,000	—
2009 Winter Offering – II	March 12, 2010	172,502	—
2009 Spring	April 30, 2010	170,500	—
2009 Summer	June 30, 2010	<u>75,000</u>	<u>—</u>
Sub-total		1,257,522	896,720
Less, remaining debt discount		<u>(370,487)</u>	<u>(593,595)</u>
		887,035	303,125
Less: Convertible debentures, net, related parties		<u>(39,782)</u>	<u>(12,466)</u>
Convertible debentures, net, others		<u>\$ 847,253</u>	<u>\$ 290,659</u>

### ***2008 Summer Offering***

From July 17, 2008 to August 31, 2008, the Company conducted an offering (the “2008 Summer Offering”) of up to \$600,000 aggregate face amount of its convertible notes (the “2008 Summer Offering”) with a small number of accredited investors. Of this amount \$484,000 aggregate face amount of the 2008 Summer Notes were sold for an aggregate purchase price of \$440,000 net proceeds. Therefore, while the stated interest rate on the 2008 Summer Notes is 0%, the implied interest rate on the 2008 Summer Notes is 10%. The 2008 Summer Notes will mature on the first anniversary of the date of issuance. The 2008 Summer Notes are convertible, at the option of the noteholders, into shares of common stock of the Company (the “Conversion Shares”) at a conversion price equal to the average of the closing bid price of the Company’s common stock for the five trading days preceding the closing date of the 2008 Summer Offering (the “Conversion Price”). Up to 1,423,530 Conversion Shares are issuable at a Conversion Price of \$0.34 per share.

Each of the investors in the 2008 Summer Offering received, for no additional consideration, a warrant (the “2008 Summer Warrants”), entitling the holder to purchase a number of shares of the Company’s common stock equal to 50% of the number of shares of common stock into which the (2008 Summer Notes) are convertible (the “2008 Summer Warrant Shares”). Each 2008 Summer Warrant is exercisable on a cash basis only at a price of \$0.50 per share, and is exercisable for a period of two years from the date of issuance. Up to 711,764, 2008 Summer Warrant Shares are initially issuable upon exercise of the 2008 Summer Warrants. As of June 30, 2009, investors have converted \$143,000 of the Convertible Notes into 420,589 shares of the Company’s common stock. The outstanding balance at June 30, 2009 was \$341,000.

The aggregate value of the Summer 2008 Offering Warrants issued in connection with the August 31, 2008 closing were valued at \$92,711 using the Black-Scholes option valuation model with the following assumptions; risk-free interest rate of 4.27%; dividend yield of 0%; volatility factors of the expected market price of common stock of 137.95%; and an expected life of two years (statutory term) and vest immediately upon issuance. The Company also determined that the notes contained a beneficial conversion feature of \$179,416. The value of the 2008 Summer Offering Warrants, the beneficial conversion feature, and the transaction fees of \$44,000 are considered as debt discount and are being amortized over the life of the Note.

### ***2008 Fall Offering***

From September 8, 2008 to October 31, 2008, the Company conducted an offering (the “2008 Fall Offering”) of up to \$500,000 aggregate face amount of its Convertible Notes. A total of \$198,220 aggregate face amount of the 2008 Fall Notes were sold for an aggregate purchase price of \$180,200 net proceeds. Therefore, while the stated interest on the 2008 Fall Notes is 0%, the implied interest rate on the 2008 Fall Notes is 10%. The 2008 fall notes will mature on the first anniversary of the date of issuance. The 2008 Fall Notes are convertible, at the option of the noteholders, into shares of common stock of the Company (the “Conversion Shares”) at a conversion price equal to the average of the closing bid price of the Company’s common stock for the five trading days preceding the closing date of the 2008 Fall Offering (the “Conversion Price”). Up to 1,321,466 Conversion Shares are issuable at a Conversion Price of \$0.15 per share.

Each of the investors in the 2008 Fall Offering received, for no additional consideration, a warrant (the “2008 Fall Warrants”), entitling the holder to purchase a number of shares of the Company’s common stock equal to 50% of the number of shares of common stock into which the (2008 Fall Notes) are convertible (the “2008 Fall Warrant Shares”). Each 2008 Fall Warrant is exercisable on a cash basis only at a price of \$0.50 per share, and is exercisable for a period of two years from the date of issuance. Up to 660,734 2008 Fall Warrant Shares are initially issuable upon exercise of the 2008 Fall Warrants. As of June 30, 2009, investors have converted \$70,400 of the Convertible Notes into 469,333 shares of the Company’s common stock. The outstanding balance at June 30, 2009 was \$127,820.

The aggregate value of the Fall 2008 Offering Warrants issued in connection with the October 31, 2008 closing were valued at \$53,320 using the Black-Scholes option valuation model with the following assumptions; risk-free interest rate of 4.68%; dividend yield of 0%; volatility factors of the expected market price of common stock of 145.98%; and an expected life of two years (statutory term) and vest immediately upon issuance. The Company also determined that the notes contained a beneficial conversion feature of \$126,880. The value of the Fall 2008 Offering Warrants, the beneficial conversion feature, and the transaction fees of \$18,020 are considered as debt discount and are being amortized over the life of the Note.

### ***2008 Winter Offering***

From November 24, 2008 to December 5, 2008, the Company conducted an offering (the "2008 Winter Offering") of up to \$500,000 aggregate face amount of its Convertible Notes. A total of \$524,700 aggregate face amount of the 2008 Winter Notes were sold for an aggregate purchase price of \$477,000 net proceeds. Therefore, while the stated interest on the 2008 Winter Notes is 0%, the implied interest rate on the 2008 Winter Notes is 10%. The 2008 Winter Notes will mature on the first anniversary of the date of issuance. The 2008 Winter Notes are convertible, at the option of the noteholders, into shares of common stock of the Company (the "Conversion Shares") at a conversion price equal to the average of the closing bid price of the Company's common stock for the five trading days preceding the closing date of the 2008 Winter Offering (the "Conversion Price"). Up to 3,086,470 Conversion Shares are issuable at a Conversion Price of \$0.17 per share.

Each of the investors in the 2008 Winter Offering received, for no additional consideration, a warrant (the "2008 Winter Warrants"), entitling the holder to purchase a number of shares of the Company's common stock equal to 50% of the number of shares of common stock into which the (2008 Winter Notes) are convertible (the "2008 Winter Warrant Shares"). Each 2008 Winter Warrant is exercisable on a cash basis only at a price of \$0.30 per share, and is exercisable for a period of two years from the date of issuance. Up to 1,543,235 2008 Winter Warrant Shares are initially issuable upon exercise of the 2008 Winter Warrants. As of June 30, 2009, investors have converted \$407,000 of the Convertible Notes into 2,394,117 shares of the Company's common stock. The outstanding balance at June 30, 2009 was \$117,700.

The aggregate value of the Winter 2008 Offering Warrants issued in connection with the December 5, 2008 closing were valued at \$168,925 using the Black-Scholes option valuation model with the following assumptions; risk-free interest rate of 3.42%; dividend yield of 0%; volatility factors of the expected market price of common stock of 153.56%; and an expected life of two years (statutory term) and vest immediately upon issuance. The Company also determined that the notes contained a beneficial conversion feature of \$308,075. The value of the Winter 2008 Offering Warrants, the beneficial conversion feature, and the transaction fees of \$47,700 are considered as debt discount and are being amortized over the life of the Note.

### ***2009 Winter Offering I***

From January 13, 2009, through January 26, 2009, Save the World Air, Inc. (the "Company") conducted and concluded a private offering (the "Winter 2009 Offering I") of up to \$250,000 aggregate face amount of its convertible notes (the "Winter 2009 Notes") with 8 accredited investors. A total of \$250,000 aggregate face amount of the Winter 2009 Notes were sold for an aggregate purchase price of \$250,000. The Winter 2009 Notes bear interest at 10% per annum, payable at maturity. The Winter 2009 Notes mature three months from their date of issuance and are currently in default. The Winter 2009 Notes are convertible, at the option of the noteholder, into shares of common stock of the Company (the "Conversion Shares") at an initial conversion price equal to the average of the closing bid price of the Company's common stock for the five trading days preceding the closing dates of the Winter 2009 Offering (the "Conversion Price"). Up to 694,444 Conversion Shares are initially issuable at a Conversion Price of \$0.36 per share.

Each of the investors in the Winter 2009 Offering received, for no additional consideration, a warrant (the "Winter 2009 Warrants"), entitling the holder to purchase a number of shares of the Company's common stock equal to 50% of the number of shares of common stock into which the Winter 2009 Notes are convertible (the "Warrant Shares"). Each Winter 2009 Warrant is exercisable on a cash basis only at an initial price of \$0.50 per share, and is exercisable immediately upon issuance and for a period of two (2) years from the date of issuance. Up to 347,722 Warrant Shares are initially issuable on exercise of the Winter 2009 Warrants.

The aggregate value of the Winter 2009 Offering Warrants issued in connection with the January 26, 2009 closing were valued at \$66,178 using the Black-Scholes option valuation model with the following assumptions; risk-free interest rate of 0.85%; dividend yield of 0%; volatility factors of the expected market price of common stock of 151.42%; and an expected life of two years (statutory term) and vest immediately upon issuance. The Company also determined that the notes contained a beneficial conversion feature of \$183,822. The value of the Winter 2009 Offering Warrants and the beneficial conversion feature are considered as debt discount and are being amortized over the life of the notes.

As of June 30, 2009, investors have converted \$20,000 of the Convertible Notes into 55,556 shares of the Company's common stock. The outstanding balance at June 30, 2009 was \$253,000 which was due on April 26, 2009. The Company is currently negotiating an extension of these outstanding Notes.

### ***2009 Winter Offering II***

From February 4, 2009, through March 11, 2009, the Company conducted and concluded a private offering (the "Winter 2009 Offering II") of up to \$250,000 aggregate face amount of its convertible notes (the "Winter 2009 #2 Notes") with 17 accredited investors. A total of \$247,302 aggregate face amount of the Winter 2009 #2 Notes were sold for an aggregate purchase price of \$224,820. While the stated interest rate on the Winter 2009#2 Notes is 0%, the actual interest rate on the Winter 2009 #2 Notes is 10% per annum. The Winter 2009 #2 Notes mature on the first anniversary of their date of issuance. The Winter 2009 #2 Notes are convertible, at the option of the noteholder, into shares of common stock of the Company (the "Conversion Shares") at an initial conversion price equal to the average of the closing bid price of the Company's common stock for the five trading days preceding the closing dates of the Winter 2009 #2 Offering (the "Conversion Price"). Up to 772,818 Conversion Shares are initially issuable at a Conversion Price of \$0.32 per share.

Each of the investors in the Winter 2009 #2 Offering received, for no additional consideration, a warrant (the "Winter 2009 #2 Warrants"), entitling the holder to purchase a number of shares of the Company's common stock equal to 50% of the number of shares of common stock into which the Winter 2009 #2 Notes are convertible (the "Warrant Shares"). Each Winter 2009 #2 Warrant is exercisable on a cash basis only at an initial price of \$0.50 per share, and is exercisable immediately upon issuance and for a period of two (2) years from the date of issuance. Up to 386,409 Warrant Shares are initially issuable on exercise of the Winter 2009 #2 Warrants.

The Company received \$224,820 in net proceeds in the Winter 2009 #2 Offering which will be used for general corporate purposes and working capital. The aggregate value of the Winter 2009 #2 Offering Warrants issued in connection with the January 26, 2009 closing were valued at \$62,028 using the Black-Scholes option valuation model with the following assumptions; risk-free interest rate of 0.70%; dividend yield of 0%; volatility factors of the expected market price of common stock of 136.76%; and an expected life of two years (statutory term) and vest immediately upon issuance. The Company also determined that the notes contained a beneficial conversion feature of \$162,792. The value of the Winter 2009 #2 Offering Warrants, the beneficial conversion feature, and the transaction fees of \$22,482 are considered as debt discount and are being amortized over the life of the Note.

As of June 30, 2009, investors have converted \$74,800 of the Convertible Notes into 233,750 shares of the Company's common stock. The outstanding balance at June 30, 2009 was \$172,502.

### ***2009 Spring Offering***

On April 30, 2009, the Company closed its 2009 Spring Offering. From March 17, 2009, through April 30, 2009, the Company conducted and concluded a private offering (the "Spring 2009 Offering") of up to \$300,000 aggregate face amount of its convertible notes (the "Spring 2009 Notes") with 11 accredited investors. A total of \$181,500 aggregate face amount of the Spring 2009 Notes were sold for an aggregate purchase price of \$165,000. The Spring 2009 Notes mature on the first anniversary of their date of issuance, are convertible, at the option of the noteholder, into up to 672,222 shares of common stock of the Company at a conversion price of \$0.27 per share.

Each of the investors in the Spring 2009 Offering received, for no additional consideration, a warrant (the "Spring 2009 Warrants"), entitling the holder to purchase a number of shares of the Company's common stock equal to 50% of the number of shares of common stock into which the Spring 2009 Notes are convertible (the "Warrant Shares"). Each Spring 2009 Warrant is exercisable on a cash basis only at an initial price of \$0.50 per share, and is exercisable for a period of two years. Up to 336,111 Warrant Shares are initially issuable on exercise of the Spring 2009 Warrants.

The Company received \$165,000 in net proceeds in the Spring 2009 Offering which will be used for general corporate purposes and working capital. The aggregate value of the Spring 2009 Offering Warrants issued in connection with the April 30, 2009 closing were valued at \$39,994 using the Black-Scholes option valuation model with the following assumptions; risk-free interest rate of 0.94%; dividend yield of 0%; volatility factors of the expected market price of common stock of 156.39%; and an expected life of two years (statutory term) and vest immediately upon issuance. The Company also determined that the notes contained a beneficial conversion feature of \$96,827. The value of the Spring 2009 Offering Warrants, the beneficial conversion feature, and the transaction fees of \$16,500 are considered as debt discount and are being amortized over the life of the Note.

As of June 30, 2009, investors have converted \$11,000 of the Convertible Notes into 40,740 shares of the Company's common stock. The outstanding balance at June 30, 2009 was \$170,500.

## 2009 Summer Offering

On June 9, 2009, we began conducting a private offering (the “Summer 2009 Offering”) of up to \$500,000 aggregate face amount of our convertible notes (the “Summer 2009 Notes”) with interest compounded quarterly at the annual rate of seven percent (7%) payable at maturity. As of June 30, 2009, 4 accredited investors had invested a total of \$75,000 aggregate face amount of the Summer 2009 Notes for an aggregate purchase price of \$75,000. The Summer 2009 Notes mature on the second anniversary of the closing of this offering and will be convertible, at the option of the noteholder, into up to 300,000 shares of common stock of the Company at a conversion price of \$0.25 per share.

Each of the investors in the Summer 2009 Offering will receive, for no additional consideration, a warrant (the “Summer 2009 Warrants”), entitling the holder to purchase a number of shares of our common stock equal to 100% of the number of shares of common stock into which the Summer 2009 Notes are convertible (the “Warrant Shares”). Each Summer 2009 Warrant is exercisable on a cash basis only at an initial price of \$0.30 per share, and is exercisable for a period of thirty six months. Up to 300,000 Warrant Shares are initially issuable on exercise of the Summer 2009 Warrants. The Company will account for value of the warrants and any conversion feature of the notes when the offering is complete and the notes are issued and the final terms are known.

The outstanding balance at June 30, 2009 was \$75,000.

## 6. Capital stock

During the six months ended June 30, 2009, the Company issued 2,014,914 shares of common stock in exchange for conversion of \$416,129 of Convertible Notes.

During the six months ended June 30, 2009, the Company granted 502,355 shares of common stock in exchange for consulting services in the amount of \$174,413.

## 7. Stock options and warrants

### Options

The Company currently issues stock options to employees, directors and consultants under the 2004 Stock Option Plan (the Plan). The Company could issue options under the Plan to acquire up to 5,000,000 shares of common stock. In February 2006, the board approved an amendment to the Plan (approved by the Shareholders in May 2006), increasing the authorized shares by 2,000,000 shares to 7,000,000 shares. At June 30, 2009, 2,698,775 were available to be granted under the Plan. Prior to 2004, the Company granted 3,250,000 options outside the Plan to officers of the Company of which 250,000 are still outstanding.

Employee options vest according to the terms of the specific grant and expire from 5 to 10 years from date of grant. Non-employee option grants to date are vested upon issuance. The weighted-average, remaining contractual life of employee options outstanding at June 30, 2009 was 8.2 years. Stock option activity for the period January 1, 2009 to June 30, 2009, was as follows:

	<b>Weighted Avg. Options</b>	<b>Weighted Avg. Exercise Price</b>
Options outstanding, January 1, 2009	4,601,225	\$ 0.53
Options granted	—	—
Options exercised	(50,000)	0.27
Options forfeited	—	—
Options cancelled	—	—
Options outstanding, June 30, 2009	<u>4,551,225</u>	<u>\$ 0.54</u>

The weighted average exercise prices, remaining contractual lives for options granted, exercisable, and expected to vest under the Plan as of June 30, 2009 were as follows:

Option Exercise Price Per Share	Outstanding Options			Exercisable Options	
	Shares	Life (Years)	Weighted Average Exercise Exercise Price	Shares	Weighted Average Exercise Price
\$ 0.21 - \$ 0.99	4,163,679	8.4	\$ 0.46	3,913,679	\$ 0.46
\$ 1.00 - \$ 1.99	327,546	5.8	\$ 1.41	327,546	\$ 1.41
\$ 2.00 - \$ 2.26	60,000	2.6	\$ 2.26	60,000	\$ 2.26
	<u>4,551,225</u>	<u>8.2</u>	<u>\$ 0.53</u>	<u>4,301,225</u>	<u>\$ 0.54</u>

As of June 30, 2009 the market price of the Company's stock was \$0.40 per share. Future unamortized compensation expense on the outstanding options at June 30, 2009 is \$7,416. At June 30, 2009, the aggregate intrinsic value of the options outstanding and exercisable was \$315,000.

#### *Black-Scholes value of options*

During the six months ended June 30, 2009 and 2008, the Company valued options for pro-forma purposes at the grant date using the Black-Scholes pricing model with the following average assumptions:

	June 30,	
	2009	2008
Expected life (years)	1.25	5.5
Risk free interest rate	1%	4.42%
Volatility	155%	124.57%
Expected dividend yield	0.00%	0.00%

The weighted average fair value for options granted in 2008 was \$0.24. During the six months ended June 30, 2009, no options were granted.

#### Warrants

The following table summarizes certain information about the Company's stock purchase warrants from January 1, 2009 to June 30, 2009.

	Weighted	
	Warrants	Avg. Exercise Price
Warrants outstanding, January 1, 2009	10,400,003	\$ 0.70
Warrants granted	1,079,743	0.50
Warrants exercised	—	—
Warrants cancelled	(1,083,418)	—
Warrants outstanding, June 30, 2009	<u>10,396,328</u>	<u>\$ 0.60</u>

Warrant Exercise Price Per Share	Outstanding Warrants			Exercisable Warrants	
	Shares	Life (Years)	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
\$ 0.30 - \$ 0.99	8,251,060	1.6	\$ 0.48	8,251,060	\$ 0.48
\$ 1.00 - \$ 1.99	2,057,966	2.4	\$ 1.00	2,057,966	\$ 1.00
\$ 2.00 - \$ 2.70	87,302	1.9	\$ 2.70	87,302	\$ 2.70
	<u>10,396,328</u>		<u>\$ 0.60</u>	<u>10,396,328</u>	<u>\$ 0.60</u>

As of June 30, 2009 the market value of the Company's stock was \$0.40 per share, and the aggregate intrinsic value of the warrants outstanding was \$-0-



## 8. Research and development

The Company has research and development facilities in Morgan Hill, California. The Company has tested products incorporating our ZEFS, MK IV and ELEKTRA technologies for multiple makes and models diesel engines, motorbikes, boats, generators, lawnmowers and other small engines. The Company has purchased test vehicles, test engines and testing equipment. The Company incurred \$262,060 and \$322,362 for the six months ended June 30, 2009 and 2008, respectively, on its research and development activities.

### Temple University License Agreements

The Company has entered into a research and development agreement (R&D Agreement) with Temple University to conduct further research on the ELEKTRA technology. Under the R&D Agreement Temple University will conduct a 24-month research project towards expanding the scope of, and developing products utilizing, the technologies covered under the License Agreements, including design and manufacture of prototypes utilizing electric fields to improve diesel, gasoline and kerosene fuel injection in engines using such fuels and a device utilizing a magnetic field to reduce crude oil viscosity for crude oil (paraffin and mixed base) and edible oil flow in pipelines. If the research project yields results within the scope of the technologies licensed pursuant to the License Agreements, those results will be deemed included as rights licensed to the Company pursuant to the License Agreements. If the research project yields results outside of the scope of the technologies covered by the License Agreements, the Company has a six-month right of first negotiation to enter into a new worldwide, exclusive license agreement with Temple University for the intellectual property covered by those results.

The Company has entered into three License Agreements with Temple University covering Temple University's current patent applications concerning certain electric field effects on gasoline, kerosene and diesel fuel particle size distribution, and concerning electric field effects on crude oil and edible oil viscosity. Initially, the License Agreements are exclusive and the territory licensed to the Company is worldwide. Pursuant to the License Agreements, the Company will pay to Temple University (i) license fees in the aggregate amount of \$300,000. A payment of \$50,000 was due on November 1, 2006; a payment of \$100,000 was due on March 2, 2007; a payment of \$75,000 was due on February 2, 2008 and the final payment was due on February 2, 2009. Annual maintenance fees of \$25,000 for the first license were due on November 1, 2007 and November 1, 2008. Annual maintenance payments of \$125,000 for two of the licenses were due January 1, 2008. In addition, each License Agreement separately provides that the Company will pay royalties to Temple University on net sales of products incorporating the technology licensed under that License Agreement in an amount equal to 7% of the first \$20 million of net sales, 6% of the next \$20 million of net sales and 5% of net sales in excess of \$40 million. Sales under the three License Agreements are not aggregated for purposes of calculating the royalties payable to Temple University. In addition, the Company has agreed to bear all costs of obtaining and maintaining patents in any jurisdiction where the Company directs Temple University to pursue a patent for either of the licensed technologies. Should the Company not wish to pursue a patent in a particular jurisdiction, that jurisdiction would not be included in the territory licensed to the Company.

The Company has also entered into a research and development agreement (R&D Agreement) with Temple University to conduct further research on the ELEKTRA technology. Under the R&D Agreement Temple University will conduct a 24-month research project towards expanding the scope of, and developing products utilizing, the technologies covered under the License Agreements, including design and manufacture of prototypes utilizing electric fields to improve diesel, gasoline and kerosene fuel injection in engines using such fuels and a device utilizing a magnetic field to reduce crude oil viscosity for crude oil (paraffin and mixed base) and edible oil flow in pipelines. If the research project yields results within the scope of the technologies licensed pursuant to the License Agreements, those results will be deemed included as rights licensed to the Company pursuant to the License Agreements. If the research project yields results outside of the scope of the technologies covered by the License Agreements, the Company has a six-month right of first negotiation to enter into a new worldwide, exclusive license agreement with Temple University for the intellectual property covered by those results. Pursuant to the R&D Agreement, the Company will make payments to Temple University in the aggregate amount of \$500,000

At December 31, 2008, the Company was in default in the amount of \$300,000 in connection with its payment obligations under the License Agreements and maintenance payments. On November 10, 2008, the Company received written notice from Temple University of a material breach relating to required payments under the License Agreements. The notice provides the Company with 60 days' notice to cure the material breach. The Company's failure to cure could result in a termination of the License Agreements. If the termination occurs, the Company estimates this would have a material adverse impact on the Company's financial condition and operations. Under the License Agreements the Company is subject to a penalty of 1% per month of the amounts due and unpaid under the License Agreements.

At December 31, 2008, the Company was in default in the amount of \$376,250 under the R&D Agreement. On November 10, 2008, the Company received written notice of default from Temple University. The notice provides the Company with 60 days to cure the material breach. The Company's failure to cure the breach could result in the termination of the R&D Agreement. If the termination occurs, the Company estimates this would have a material adverse impact on the Company's financial condition and operations.

On January 9, 2009, the Company entered into a Letter Agreement with Temple University wherein Temple University granted to the Company an extension of time to cure the above-referenced breaches until March 31, 2009. The Letter Agreement provides for payments of \$100,000 on each of January 31, 2009, February 28, 2009 and March 31, 2009. The Company made the January 31, 2009 payment but did not make the payment due on February 28, 2009. On March 26, 2009, the Company received a written extension for both the February 28, 2009 payment and the March 31, 2009 payment until April 30, 2009. All additional amounts past due as of December 31, 2008 and additional License and Maintenance Fees of \$200,000 which became due the first quarter of 2009 were to be re-negotiated on or before April, 2009, however, this has now been extended to September 30, 2009. (See Note 10)

At June 30, 2009, the Company owed to Temple University a total of \$400,000 for the License Agreements and Maintenance Fees; \$376,250 for the R&D Agreement and \$64,500 in penalties for a total of \$840,750. A penalty equal to 1% of the amount due and unpaid on the first day of each calendar month will be added to the outstanding amount due Temple University.

The Company has provided for all past due amounts in the financial statements at June, 2009 and December 31, 2008. Fees due Temple University as of June 30, 2009 and December 31, 2008 were \$840,750 and \$716,500, respectively, and are included in accounts payable-Temple University in the accompanying condensed consolidated financial statements. During the six months ended June, 2009 and 2008, the Company recorded \$224,250 and \$316,750, respectively, of fees and penalties due to Temple University.

## **9. Commitments and contingencies**

### *Legal matters*

On December 19, 2001, the SEC filed civil charges in the United States Federal District Court, Southern District of New York, against the Company, the Company's former President and then sole director Jeffrey A. Muller, and others, alleging that the Company and the other defendants were engaged in a fraudulent scheme to promote the Company's stock. The SEC complaint alleged the existence of a promotional campaign using press releases, Internet postings, an elaborate website, and televised media events to disseminate false and materially misleading information as part of a fraudulent scheme to manipulate the market for stock in the Company which was then controlled by Mr. Muller. On March 22, 2002, the Company signed Consent to Final Judgment of Permanent Injunction and Other Relief in settlement of this action as against the corporation only, which the Court approved on July 2, 2002. Under this settlement, the Company was not required to admit fault and did not pay any fines or restitution.

On July 2, 2002, after an investigation by the Company's newly constituted board of directors, the Company filed a cross-complaint in the SEC action against Mr. Muller and others seeking injunctive relief, disgorgement of monies and stock and financial restitution for a variety of acts and omissions in connection with sales of the Company's stock and other transactions occurring between 1998 and 2002. Among other things, the Company alleged that Mr. Muller and certain others sold Company stock without providing adequate consideration to the Company; sold insider shares without making proper disclosures and failed to make necessary filing required under federal securities laws; engaged in self-dealing and entered into various undisclosed related-party transactions; misappropriated for their own use proceeds from sales of the Company's stock; and entered into various undisclosed arrangement regarding the control, voting and disposition of their stock.

On July 30, 2002, the U.S. Federal District Court, Southern District of New York, granted the Company's application for a preliminary injunction against Mr. Muller and others, which prevented Mr. Muller and other cross-defendants from selling, transferring, or encumbering any assets and property previously acquired from the Company, from selling or transferring any of the Company's stock that they may have owned or controlled, or from taking any action to injure the Company or the Company's business and from having any direct contact with the Company's shareholders. The injunctive order also prevented Mr. Muller or his nominees from engaging in any effort to exercise control over the Company's corporation and from serving as an officer or director of the Company. In the course of the litigation, the Company has obtained ownership control over all patent rights to the ZEFS device.

On January 4, 2007, the Court entered a final judgment against Jeffrey Muller which barred Mr. Muller from serving as an officer or director of a public company for a period of 20 years, ordered Mr. Muller to disgorge any shares of the Company's stock that he still owns and directed the Company to cancel any issued and outstanding shares of the Company's stock still owned by Mr. Muller. Mr. Muller was also ordered to disgorge unlawful profits in the amount of \$7.5 million and to pay a civil penalty in the amount of \$100,000. Acting in accordance with the ruling and decision of the Court, the Company has canceled (i) 8,047,403 shares of common stock that had been held by Mr. Muller and/or his affiliates, (ii) options to acquire an additional 10,000,000 shares of the Company's common stock held by Mr. Muller personally and (iii) \$1,017,208 of debt which Mr. Muller claimed was owed to him by the Company. After an appeal filed by Mr. Muller was dismissed the Judgment against him is considered final.

On February 8, 2007, Federal Magistrate Judge Maas issued a post-judgment order, at the Company's request, which further concluded that all of the shares of the Company's stock held by Mr. Muller or any of his nominees directly or indirectly owned or controlled were to be recaptured by the Company and were subject to disgorgement and forfeiture. The ruling provided that all shares, options and any other obligations allegedly owed by the Company to Mr. Muller were to be disgorged in our favor and confirmed the earlier judgment holding Mr. Muller liable for \$7.5 million in actual damages, imposing a \$100,000 fine and barring Mr. Muller from any involvement with a publicly traded company for 20 years. With prejudgment interest, this ruling brings the actual damages against Muller to over \$11 million. Additionally, the Court clarified that the order required the disgorgement of any shares of the Company's stock that Mr. Muller or any of his nominees directly or indirectly owned or controlled. In furtherance of this order, the Company has taken action to cancel over 3.6 million shares which had been issued to offshore companies. The Order also confirmed the appropriateness of actions previously taken by the Company to acquire the patent rights and to consolidate the manufacturing, marketing and distribution rights with its ownership of all rights to the existing patents. On February 11, 2009, Judge Maas confirmed that his previous decision was modified and Save the World Air's Motion for Summary Judgment was granted in favor of Save the World Air as set forth in his order of February 8, 2007. A proposed Final Judgment in favor of Save the World Air is pending before the United States District Court, Southern District of New York.

#### ***Litigation Involving Scottish Glen Golf Company***

We were involved in litigation with Scottish Glen Golf Company, Inc. (SGGC) doing business as KZ Golf, Inc., the Company's previous landlord on claims in the aggregate amount of \$104,413. The Company did not dispute the fact that certain amounts of unpaid past rent are due but did dispute that it owes the aggregate of \$104,413 demanded by SGGC; more than half of which are purported "late fees" which was assessed at the rate of \$100 per day. It was the Company's position that the late fees are void and unenforceable and that the Company is entitled to a set-off for office space that reverted back to SGGC.

On April 30, 2008 the Company and SGGC settled their pending litigation relating to the Company's prior offices. The Company paid to SGGC \$51,000 in full settlement of SGGC's claims. On May 28, 2008 the initial payment of \$34,000 was made and on July 9, 2008 the final payment of \$17,000 was made and the Complaint was dismissed, with prejudice. The Company recorded \$52,069 as other income and as a reduction of accounts payable.

#### **10. Subsequent events**

On April 29, 2009, the Company received from Temple University a written extension of the January 9, 2009 Letter Agreement. The agreement provides an extension of the \$100,000 due to Temple on February 28, 2009 and \$100,000 due March 30, 2009 to May 29, 2009. The Company expects that all payments regarding past due amounts, with the exception of the prescribed payments, will be renegotiated on or before May 29, 2009. On August 12, 2009 the Company received an extension until September 30, 2009.

On June 9, 2009, the Company began conducting a private offering (the "Summer 2009 Offering") of up to \$500,000 aggregate face amount of its convertible notes (the "Summer 2009 Notes") with interest compounded quarterly at the annual rate of seven percent (7%) payable at maturity. As of June 30, 2009, 4 accredited investors had invested a total of \$75,000,000 aggregate face amount of the Spring 2009 Notes for an aggregate purchase price of \$75,000,000. The Summer 2009 Notes mature on the second anniversary of the closing of this offering and will be convertible, at the option of the noteholder, into up to 300,000 shares of common stock of the Company at a conversion price of \$0.25 per share.

Each of the investors in the Summer 2009 Offering will receive, for no additional consideration, a warrant (the "Summer 2009 Warrants"), entitling the holder to purchase a number of shares of the Company's common stock equal to 100% of the number of shares of common stock into which the Summer 2009 Notes are convertible (the "Warrant Shares"). Each Summer 2009 Warrant is exercisable on a cash basis only at an initial price of \$0.30 per share, and is exercisable for a period of thirty six months. Up to 300,000 Warrant Shares are initially issuable on exercise of the Spring 2009 Warrants.

Subsequent to June 30, 2009, the Company has received from 2 accredited investors a total of \$50,000 which will be convertible, at the option of the noteholders, into up to 125,000 shares of the common stock of the Company and for no additional consideration a warrant will be issued entitling the holder to purchase 125,000a of shares of the Company's common stock. The original closing date of June 30, 2009 has been extended to August 31, 2009.

In August, 2009, an officer and director advanced to the Company \$13,500, repayable upon demand.

## **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

This Quarterly Report on Form 10-Q contains forward-looking statements. These forward-looking statements include predictions regarding our future:

- revenues and profits;
- customers;
- research and development expenses and efforts;
- scientific and other third-party test results;
- sales and marketing expenses and efforts;
- liquidity and sufficiency of existing cash;
- technology and products;
- the outcome of pending or threatened litigation; and
- the effect of recent accounting pronouncements on our financial condition and results of operations

You can identify these and other forward-looking statements by the use of words such as "may," "will," "expects," "anticipates," "believes," "estimates," "continues," or the negative of such terms, or other comparable terminology.

Forward-looking statements also include the assumptions underlying or relating to any of the foregoing statements.

Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including those set forth under the heading "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2008. All forward-looking statements included in this document are based on information available to us on the date hereof. We assume no obligation to update any forward-looking statements.

### **Overview**

The following discussion and analysis of our condensed consolidated financial condition and condensed consolidated results of operations should be read in conjunction with the condensed consolidated financial statements and notes thereto included in Part I, Item 1 of this Form 10-Q and the condensed consolidated financial statements and notes thereto contained in our Annual Report on Form 10-K for the fiscal year ended December 31, 2008.

We are a green technology company that leverages a suite of patented, patent-pending and licensed intellectual properties related to the treatment of fuels. Technologies patented by, or licensed to, us utilize either magnetic or uniform electrical fields to alter physical characteristics of fuels and are designed to create a cleaner combustion. Cleaner combustion has been shown to improve performance, enhance fuel economy and/or reduce harmful emissions in laboratory testing.

Our ECO ChargR™ and MAG ChargR™ products use fixed magnetic fields to alter some physical properties of fuel, by incorporating our patented and patent-pending ZEFS and MK IV technologies. We differentiate ECO ChargR and MAG ChargR products based on their differing attributes and marketing focus. ECO ChargR products are primarily designed to reduce harmful emissions and MAG ChargR products are primarily designed to enhance performance and fuel economy. Our ECO ChargR product is intended to reduce exhaust emissions in vehicle and small utility motors. ECO ChargR will be marketed primarily to original equipment manufacturers (“OEMs”) as well as to pilot and government-mandated emissions programs. Our MAG ChargR product is intended to increase power and improve mileage. MAG ChargR will be marketed primarily to the specialty consumer accessories market for many types of vehicles, including but not limited to cars, trucks, motorcycles, scooters, all terrain vehicles (“ATVs”), snowmobiles, personal watercraft and small utility motors. Because our ECO ChargR and MAG ChargR products are customized to specific brands, models and engine sizes, these products ultimately will require individually developed parts, which can be expensive and time-consuming to produce. See “Our Technologies and Products” below.

Our first revenues have come from initial sales in Asia for our ECO ChargR product in the motorcycle industry. We plan on commencing sales of ECO ChargR to customers in the United States in the motorcycle industry in third quarter of 2009. We also plan on commencing initial sales of our MAG ChargR product in the United States in the automobile and motorcycle industry in the third quarter of 2009. See “Recent Developments” and “Sales and Marketing” below.

We have obtained a license from Temple University for their patent-pending uniform electric field technology, tentatively called ELEKTRA™. The ELEKTRA technology consists of passing fuel through a specific strong electrical field. Although ELEKTRA has a similar effect on fuels as our ZEFS and MK IV technologies, ELEKTRA incorporates a uniform electrical field principle. Based on our early research and product development, we believe that ELEKTRA carries certain advantages over our ZEFS and MK IV technologies, primarily not requiring as many variations for products incorporating the ELEKTRA technology compared to products incorporating the ZEFS or MK IV technologies. Preliminary testing conducted in Europe by an outside research and development facility indicates that ELEKTRA causes a significant change in some of the physical characteristics of the fuel, resulting in better atomization of the fuel and improved combustion.

We have also entered into a research and development agreement with Temple University to conduct further research on the ELEKTRA technology and magnetic technologies in general. Together with Temple University, we have developed prototype products using the ELEKTRA technology and we are continuing testing, and research and development. We are in the early stages of developing ELEKTRA products that, based on the previously mentioned preliminary testing, is intended to improve fuel economy and change fuel viscosity, and may improve performance and reduce emissions, depending upon the specific application. We are also working with Temple and several domestic and international corporations investigating applications of this technology to the transportation industry, oil refineries and pipelines, and OEMs. See “Our Technologies and Products” below.

We operate in a highly competitive industry. Many of our activities may be subject to governmental regulation. We have taken aggressive steps to protect our intellectual property.

There are significant risks associated with our business, our company and our stock.

We are a development stage company that generated its first initial revenues in the fourth quarter of 2006. Our expenses to date have been funded primarily through the sale of stock and convertible debt, as well as proceeds from the exercise of stock purchase warrants. We raised capital in 2008 and the first six months of 2009 and will need to raise substantial additional capital in the balance of 2009, and possibly beyond, to fund our sales and marketing efforts, continuing research and development, and certain other expenses, until our revenue base grows sufficiently.

Our company was incorporated on February 18, 1998, as a Nevada corporation, under the name Mandalay Capital Corporation. We changed our name to Save the World Air, Inc. on February 11, 1999, following the acquisition of marketing and manufacturing rights of the ZEFS technologies. Our mailing address is 235 Tennant Avenue, Morgan Hill, California 95037. Our telephone number is (408)-778-0101. Our corporate website is [www.stwa.com](http://www.stwa.com). Information contained on the website is not deemed part of this Annual Report.

Our common stock is quoted on the Over-the-Counter Bulletin Board under the symbol “ZERO.OB”.

## **Results of Operations**

We did not generate any revenue for the three-month period and six month period ended June 30, 2009 and 2008.

Operating expenses were \$594,604 for the three-month period ended June 30, 2009, compared to \$519,860 for the three-month period ended June 30, 2008, an increase of \$74,744. This increase is attributable to increases in cash expenses of \$51,564 and non-cash expenses of \$23,180. Specifically, the cash expense increase is attributable to increases in consulting and professional fees (\$25,825), salaries and benefits (\$16,861) and miscellaneous office expenses (\$14,135), offset by decreases in travel expenses (\$4,523) and corporate expenses (\$734). The increase in non-cash expenses is primarily attributable to increases in value of stocks issued for services (\$22,800) and valuation of warrants and options given as compensation (\$1,179), offset by a decrease in depreciation (\$799).

Operating expenses were \$1,435,422 for the six-month period ended June 30, 2009, compared to \$1,280,002 for the six-month period ended June 30, 2008, an increase of \$155,420. This increase is attributable to an increase in cash expenses of \$256,933, offset by a decrease in non-cash expenses of \$101,513. The increase in cash expenses is attributable to increases in consulting and professional fees (\$164,460), salaries and benefits (\$62,900) and office and other expenses (\$31,124), offset by a decrease in travel and corporate expense (\$1,551). The non-cash decrease is attributable to a decrease in common stock issued for services (\$99,072), depreciation (\$2,671) and bad debt (\$1,380), offset by an increase in valuation of options and warrants given to employees and consultant (\$1,610).

Research and development expenses were \$15,220 for the three-month period ended June 30, 2009, compared to \$62,692 for the three-month period ended June 30, 2008, a decrease of \$47,472. This decrease is mainly attributable to a decrease in contract fees (\$47,750) offset by and increase in product testing, research and supplies (\$278).

Research and development expenses were \$262,060 for the six-month period ended June 30, 2009, compared to \$322,362 for the six-month period ended June 30, 2008, a decrease of \$60,302. This decrease is attributable to a decrease in contract fees (92,500), offset by and increase in product testing, research and supplies (\$32,198).

Other expense for the three-month period ended June 30, 2009 were \$369,720, compared to \$109,475 for the three-month period ended June 30, 2008, an increase of \$260,245. This increase is attributable to an increase in non-cash interest expense (\$206,950), cash interest expense (\$1,215), and decrease in other income (\$52,080).

Other expense for the six-month period ended June 30, 2009 were \$834,280, compared to \$1,373,510 for the six-month period ended June 30, 2008, a decrease of \$539,230. This decrease is attributable to decreases in non-cash interest expense (\$582,127), loss on sale of equipment (\$9,683) and cash interest expense (\$55), offset by decrease in other income (\$52,635).

We had a net loss of \$979,544, or \$0.02 per share, for the three-month period ended June 30, 2009, compared to a net loss of \$692,027, or \$0.02 per share, for the three-month period ended June 30, 2008. We had a net loss of \$2,531,762, or \$0.04 per share, for the six-month period ended June 30, 2009, compared to a net loss of \$2,975,874, or \$0.06 per share, for the six-month period ended June 30, 2008. We expect to incur additional net loss in the fiscal year ending December 31, 2009, primarily attributable to continued operating and marketing-related expenditures without the benefit of any significant revenue for the remainder of the year.

## **Liquidity and Capital Resources**

### **General**

Since its inception, the Company has been primarily engaged in organizational and pre-operating activities. The Company has generated insignificant revenues and has incurred accumulated losses of \$45,274,826 from February 18, 1998 (Inception) through June 30, 2009. As reflected in the accompanying condensed consolidated financial statements, the Company had a net loss of \$2,531,762 and a negative cash flow from operations of \$853,032 for the six months ended June 30, 2009, and had a working capital deficiency of \$3,973,639 and a stockholders' deficiency of \$3,847,426 at June 30, 2009. The Company is currently unable to meet its cash obligations and is in default of certain of its convertible note agreements and its obligations under its license agreements with Temple University (see Note 8). As a result, the Company's independent registered public accounting firm, in their report on the Company's 2008 consolidated financial statements, raised substantial doubt about the Company's ability to continue as a going concern.

Our operations to date have been funded through issuances of our common stock, convertible notes and preferred stock whereby we raised an aggregate \$19,149,903 from February 18, 1998 (inception) through June 30, 2009. Based on our current operating plan, we believe that we do not have sufficient cash and cash equivalents to implement our operating plan. We will need to obtain additional financing in addition to the funds already raised through the sale of equity securities to fund our cash needs and continue our operations. Additional financing, whether through public or private equity or debt financing, arrangements with stockholders or other sources to fund operations, may not be available, or if available, may be on terms unacceptable to us. Our ability to maintain sufficient liquidity is dependent on our ability to raise additional capital. If we issue additional equity securities to raise funds, the ownership percentage of our existing stockholders would be reduced. New investors may demand rights, preferences or privileges senior to those of existing holders of our common stock. Debt incurred by us would be senior to equity in the ability of debt holders to make claims on our assets. The terms of any debt issued could impose restrictions on our operations. If adequate funds are not available to satisfy either medium or long-term capital requirements, our operations and liquidity could be materially adversely affected and we could be forced to cut back our operations.

Accelerating our business plan is predicated on closure of our bridge financing. We have suffered delays associated with a new relationship that committed to do our bridge financing all the way back to the end of March 2009. STWA endured a due diligence process which was then underwritten and approved for market July, 1st 2009. Regardless of the performance associated with our primary financiers management has been able to cultivate \$175,000 of the bridge on its own and will continue to do so as a secondary measure of financing. Management has also supplemented the bridge with other possible sources of funding which could precipitate at any moment. During the past several months, executives have contributed approximately \$30,000 of their own unsecured dollars in support of the company.

## Details of Recent Financing Transactions

### *Morale Orchards, LLC and Leodis Matthews*

Leodis Matthews, through his law firm, Matthews & Partners, (“Matthews”) serves as outside legal counsel to the Company. Morale Orchards, LLC (“Morale”) is owned by Jacqueline Alexander, the wife of Leodis Matthews.

In 2006 and 2007, Morale purchased two convertible promissory notes totaling \$1,225,000. The notes were unsecured; convertible into 1,595,588 shares of common stock, due one year from the date issued, and had an implied interest rate of 22.5%. Warrants to purchase 797,794 shares of common stock were issued with the notes. As of January 31, 2008, the notes were in default, and the total amount due for the notes was \$1,362,212, including penalties and interest. In addition to the two notes, we borrowed \$20,000 from Morale on October 30, 2007. At January 31, 2008, we were also indebted to Matthews \$472,762 for past legal fee.

Effective January 31, 2008, the Company, Morale, and Matthews agreed to a settlement of our loans due Morale and fees due Matthews. Morale agreed to waive all accrued interest on the notes after January 31, 2008, and Morale and Matthews agreed to accept 7,421,896 shares of common stock of the Company as payment of the notes payable and fees.

On March 10, 2008, we issued 5,530,848 shares of the Company’s common stock valued at \$2,101,722 to Morale for the conversion of the notes (totaling \$1,362,212) and cancellation of \$20,000 Note. Also on March 10, 2008, we issued 1,891,048 shares of the Company’s common stock valued at \$718,598 to Matthews in exchange for settlement of the legal fees due Matthews of \$472,762.

The fair value of the shares of common stock issued was determined to be \$0.38 per share, based on the closing price of the Company’s common stock on January 31, 2008, for a total settlement of \$2,820,320. As a result of the issuance of shares of common stock, we incurred additional non-cash costs of \$927,903 that have been reflected as costs to settle outstanding debt in the accompanying condensed consolidated statement of operations.

**2007 Winter Offering.** >From December 27, 2007 to February 29, 2008 we conducted an offering (the “2007 Winter Offering”) of up to \$1,000,000 aggregate face amount of its convertible notes (the “2008 Winter Notes”) with a small number of accredited investors. Of this amount, \$521,400 aggregate face amount of the 2007 Winter Notes were sold for an aggregate purchase price of \$474,000 net proceeds. Therefore, while the stated interest rate on the 2007 Winter Notes is 0%, the implied interest rate on the 2007 Winter Notes is 10%. The 2007 Winter Notes mature on the first anniversary of their date of issuance. The 2007 Winter Notes are convertible, at the option of the noteholder, into shares of common stock of the Company (the “Conversion Shares”) at a conversion price equal to the average of the closing bid price of the Company’s common stock for the five trading days preceding the closing date of the 2007 Winter Offering (the “Conversion Price”). Up to 1,042,800 Conversion Shares are issuable at a Conversion Price of \$0.50 per share.

Each of the investors in the 2007 Winter Offering received, for no additional consideration, a warrant (the “2007 Winter Warrants”), entitling the holder to purchase a number of shares of the Company’s common stock equal to 50% of the number of shares of common stock into which the (2007 Winter Notes) are convertible (the “2007 Warrant Shares”) Each 2007 Winter Warrant is exercisable on a cash basis only at a Price of \$0.50 per share, and is exercisable for a period of two years from the date of issuance. Up to 521,400 2008 Warrant Shares are initially issuable on exercise of the 2007 Winter Warrants.

As of June 30, 2009, investors have converted \$521,400 of the Convertible Notes into 1,042,800 shares of the Company’s common stock. There was no outstanding balance at June 30, 2009.

**2008 Spring Offering.** On May 27, 2008, we made an offering (the “2008 Spring Offering”) with a certain investor of which, \$66,000 face amount of the 2008 Spring Note was sold for \$60,000 net proceeds. Therefore, while the stated interest rate on the 2008 Spring Note is 0%, the implied interest rate on the 2008 Spring Note is 10%. The 2008 Spring Note will mature on the first anniversary of the date of issuance. The 2008 Spring Note is convertible, at the option of the noteholder, into shares of common stock of the Company (the “Conversion Shares”) at a conversion price equal to the average of the closing bid price of the Company’s common stock for the five trading days preceding the closing date of the 2008 Spring Offering (the “Conversion Price”). The 132,000 Conversion Shares are issuable at a Conversion Price of \$0.50 per share.

The investor in the 2008 Spring Offering received, for no additional consideration, a warrant (the “2008 Spring Warrants”), entitling the holder to purchase a number of shares of the Company’s common stock equal to 50% of the number of shares of common stock into which the (2008 Spring Notes) are convertible (the “2008 Spring Warrant Shares”). The 2008 Spring Warrant Shares is exercisable on a cash basis only at a Price of \$0.50 per share, and is exercisable for a period of two years from the date of issuance. The 66,000 2008 Spring Warrant Shares are initially issuable upon exercise of the 2008 Spring Warrants.

As of June 30, 2009, the investor converted \$66,000 of the Convertible Notes into 132,000 shares of the Company’s common stock. There was no outstanding balance at June 30, 2009.

**2008 Summer Offering.** From July 17, 2008 to August 31, 2008, we conducted an offering (the “2008 Summer Offering”) of up to \$600,000 aggregate face amount of its convertible notes (the “2008 Summer Offering”) with a small number of accredited investors. Of this amount \$484,000 aggregate face amount of the 2008 Summer Notes were sold for an aggregate purchase price of \$440,000 net proceeds. Therefore, while the stated interest rate on the 2008 Summer Notes is 0%, the implied interest rate on the 2008 Summer Notes is 10%. The 2008 Summer Notes will mature on the first anniversary of the date of issuance. The 2008 Summer Notes are convertible, at the option of the noteholders, into shares of common stock of the Company (the “Conversion Shares”) at a conversion price equal to the average of the closing bid price of the Company’s common stock for the five trading days preceding the closing date of the 2008 Summer Offering (the “Conversion Price”). Up to 1,423,530 Conversion Shares are issuable at a Conversion Price of \$0.34 per share.

Each of the investors in the 2008 Summer Offering received, for no additional consideration, a warrant (the “2008 Summer Warrants”), entitling the holder to purchase a number of shares of the Company’s common stock equal to 50% of the number of shares of common stock into which the (2008 Summer Notes) are convertible (the “2008 Summer Warrant Shares”). Each 2008 Summer Warrant is exercisable on a cash basis only at a price of \$0.50 per share, and is exercisable for a period of two years from the date of issuance. Up to 711,764 2008 Summer Warrant Shares are initially issuable upon exercise of the 2008 Summer Warrants.

As of June 30, 2009, investors have converted \$143,000 of the Convertible Notes into 420,589 shares of the Company’s common stock. The outstanding Convertible Note balance at June 30, 2009 was \$341,000.

**2008 Fall Offering.** From September 8, 2008 to October 31, 2008, we conducted an offering (the “2008 Fall Offering”) of up to \$500,000 aggregate face amount of its Convertible Notes. A total of \$198,220 aggregate face amount of the 2008 Fall Notes were sold for an aggregate purchase price of \$180,200 net proceeds. Therefore, while the stated interest on the 2008 Fall Notes is 0%, the implied interest rate on the 2008 Fall Notes is 10%. The 2008 fall notes will mature on the first anniversary of the date of issuance. The 2008 Fall Notes are convertible, at the option of the noteholders, into shares of common stock of the Company (the “Conversion Shares”) at a conversion price equal to the average of the closing bid price of the Company’s common stock for the five trading days preceding the closing date of the 2008 Fall Offering (the “Conversion Price”). Up to 1,321,466 Conversion Shares are issuable at a Conversion Price of \$0.15 per share.

Each of the investors in the 2008 Fall Offering received, for no additional consideration, a warrant (the “2008 Fall Warrants”), entitling the holder to purchase a number of shares of the Company’s common stock equal to 50% of the number of shares of common stock into which the (2008 Fall Notes) are convertible (the “2008 Fall Warrant Shares”). Each 2008 Fall Warrant is exercisable on a cash basis only at a price of \$0.50 per share, and is exercisable for a period of two years from the date of issuance. Up to 660,734 2008 Fall Warrant Shares are initially issuable upon exercise of the 2008 Fall Warrants.

As of June 30, 2009, investors have converted \$70,400 of the Convertible Notes into 469,333 shares of the Company’s common stock. The outstanding Convertible Note balance at June 30, 2009 was \$127,820.

**2008 Winter Offering.** From November 24, 2008 to December 5, 2008, we conducted an offering (the “2008 Winter Offering”) of up to \$500,000 aggregate face amount of its Convertible Notes. A total of \$524,700 aggregate face amount of the 2008 Winter Notes were sold for an aggregate purchase price of \$477,000 net proceeds. Therefore, while the stated interest on the 2008 Winter Notes is 0%, the implied interest rate on the 2008 Winter Notes is 10%. The 2008 Winter Notes will mature on the first anniversary of the date of issuance. The 2008 Winter Notes are convertible, at the option of the noteholders, into shares of common stock of the Company (the “Conversion Shares”) at a conversion price equal to the average of the closing bid price of the Company’s common stock for the five trading days preceding the closing date of the 2008 Winter Offering (the “Conversion Price”). Up to 3,086,470 Conversion Shares are issuable at a Conversion Price of \$0.17 per share.

Each of the investors in the 2008 Winter Offering received, for no additional consideration, a warrant (the “2008 Winter Warrants”), entitling the holder to purchase a number of shares of the Company’s common stock equal to 50% of the number of shares of common stock into which the (2008 Winter Notes) are convertible (the “2008 Winter Warrant Shares”). Each 2008 Winter Warrant is exercisable on a cash basis only at a price of \$0.30 per share, and is exercisable for a period of two years from the date of issuance. Up to 1,543,235 2008 Winter Warrant Shares are initially issuable upon exercise of the 2008 Winter Warrants.

As of June 30, 2009, investors have converted \$407,000 of the Convertible Notes into 2,394,117 shares of the Company’s common stock. The outstanding Convertible Note balance at June 30, 2009 was \$117,700.



**2009 Winter Offering #1.** From January 13, 2009, through January 26, 2009, we conducted and concluded a private offering (the “Winter 2009 Offering”) of up to \$250,000 aggregate face amount of its convertible notes (the “Winter 2009 Notes”) with 8 accredited investors. A total of \$250,000 aggregate face amount of the Winter 2009 Notes were sold for an aggregate purchase price of \$250,000. The Winter 2009 Notes bear interest at 10% per annum, payable at maturity. The Winter 2009 Notes mature three months from their date of issuance. The Winter 2009 Notes are convertible, at the option of the noteholder, into shares of common stock of the Company (the “Conversion Shares”) at an initial conversion price equal to the average of the closing bid price of the Company’s common stock for the five trading days preceding the closing dates of the Winter 2009 Offering (the “Conversion Price”). Up to 694,444 Conversion Shares are initially issuable at a Conversion Price of \$0.36 per share.

Each of the investors in the Winter 2009 Offering received, for no additional consideration, a warrant (the “Winter 2009 Warrants”), entitling the holder to purchase a number of shares of the Company’s common stock equal to 50% of the number of shares of common stock into which the Winter 2009 Notes are convertible (the “Warrant Shares”). Each Winter 2009 Warrant is exercisable on a cash basis only at an initial price of \$0.50 per share, and is exercisable immediately upon issuance and for a period of two (2) years from the date of issuance. Up to 347,722 Warrant Shares are initially issuable on exercise of the Winter 2009 Warrants.

The aggregate value of the Winter 2009 Offering Warrants issued in connection with the January 26, 2009 closing were valued at \$66,178 using the Black-Scholes option valuation model with the following assumptions; risk-free interest rate of 0.85%; dividend yield of 0%; volatility factors of the expected market price of common stock of 151.42%; and an expected life of two years (statutory term) and vest immediately upon issuance. The Company also determined that the notes contained a beneficial conversion feature of \$183,822. The value of the Winter 2009 Offering Warrants and the beneficial conversion feature are considered as debt discount and are being amortized over the life of the notes.

As of June 30, 2009, investors have converted \$20,000 of the Convertible Notes into 55,556 shares of the Company’s common stock. The outstanding Convertible Note balance at June 30, 2009 was \$253,000.

**2009 Winter Offering #2.** From February 4, 2009, through March 11, 2009, we conducted and concluded a private offering (the “Winter 2009 #2 Offering”) of up to \$250,000 aggregate face amount of its convertible notes (the “Winter 2009 #2 Notes”) with 17 accredited investors. A total of \$247,302 aggregate face amount of the Winter 2009 #2 Notes were sold for an aggregate purchase price of \$224,820. While the stated interest rate on the Winter 2009#2 Notes is 0%, the actual interest rate on the Winter 2009 #2 Notes is 10% per annum. The Winter 2009 #2 Notes mature on the first anniversary of their date of issuance. The Winter 2009 #2 Notes are convertible, at the option of the noteholder, into shares of common stock of the Company (the “Conversion Shares”) at an initial conversion price equal to the average of the closing bid price of the Company’s common stock for the five trading days preceding the closing dates of the Winter 2009 #2 Offering (the “Conversion Price”). Up to 772,818 Conversion Shares are initially issuable at a Conversion Price of \$0.32 per share.

Each of the investors in the Winter 2009 #2 Offering received, for no additional consideration, a warrant (the “Winter 2009 #2 Warrants”), entitling the holder to purchase a number of shares of the Company’s common stock equal to 50% of the number of shares of common stock into which the Winter 2009 #2 Notes are convertible (the “Warrant Shares”). Each Winter 2009 #2 Warrant is exercisable on a cash basis only at an initial price of \$0.50 per share, and is exercisable immediately upon issuance and for a period of two (2) years from the date of issuance. Up to 386,409 Warrant Shares are initially issuable on exercise of the Winter 2009 #2 Warrants.

We received \$224,820 in net proceeds in the Winter 2009 #2 Offering which will be used for general corporate purposes and working capital. The aggregate value of the Winter 2009 #2 Offering Warrants issued in connection with the January 26, 2009 closing were valued at \$62,028 using the Black-Scholes option valuation model with the following assumptions; risk-free interest rate of 0.70%; dividend yield of 0%; volatility factors of the expected market price of common stock of 136.76%; and an expected life of two years (statutory term) and vest immediately upon issuance. We also determined that the notes contained a beneficial conversion feature of \$161,792. The value of the Winter 2009 Offering Warrants, the beneficial conversion feature, and the transaction fees of \$22,482 are considered as debt discount and are being amortized over the life of the Note.

As of June 30, 2009, investors have converted \$74,800 of the Convertible Notes into 233,750 shares of the Company’s common stock. The outstanding Convertible Note balance at June 30, 2009 was \$172,502.

**2009 Spring Offering.** From March 17, 2009 through April 30, 2009, we conducted and concluded a private offering (the “Spring 2009 Offering”) of up to \$300,000 aggregate face amount of its convertible notes (the “Spring 2009 Notes”) with 11 accredited investors. A total of \$181,500 aggregate face amount of the Spring 2009 Notes were sold for an aggregate purchase price of \$165,000. The Spring 2009 Notes mature on the first anniversary of their date of issuance, are convertible, at the option of the noteholder, into up to 672,222 shares of common stock of the Company at a conversion price of \$0.27 per share.

Each of the investors in the Spring 2009 Offering received, for no additional consideration, a warrant (the “Spring 2009 Warrants”), entitling the holder to purchase a number of shares of the Company’s common stock equal to 50% of the number of shares of common stock into which the Spring 2009 Notes are convertible (the “Warrant Shares”). Each Spring 2009 Warrant is exercisable on a cash basis only at an initial price of \$0.50 per share, and is exercisable for a period of two years. Up to 336,111 Warrant Shares are initially issuable on exercise of the Spring 2009 Warrants.

We received \$165,000 in net proceeds in the Spring 2009 Offering which will be used for general corporate purposes and working capital. The aggregate value of the Spring 2009 Offering Warrants issued in connection with the April 30, 2009 closing were valued at \$39,994 using the Black-Scholes option valuation model with the following assumptions; risk-free interest rate of 0.94%; dividend yield of 0%; volatility factors of the expected market price of common stock of 156.39%; and an expected life of two years (statutory term) and vest immediately upon issuance. We also determined that the notes contained a beneficial conversion feature of \$96,827. The value of the Spring 2009 Offering Warrants, the beneficial conversion feature, and the transaction fees of \$16,500 are considered as debt discount and are being amortized over the life of the Note.

As of June 30, 2009, investors have converted \$11,000 of the Convertible Notes into 40,740 shares of the Company's common stock. The outstanding balance at June 30, 2009 was \$170,500.

**2009 Summer Offering.** On June 9, 2009, we began conducting a private offering (the "Summer 2009 Offering") of up to \$500,000 aggregate face amount of our convertible notes (the "Summer 2009 Notes") with interest compounded quarterly at the annual rate of seven percent (7%) payable at maturity. As of June 30, 2009, 4 accredited investors had invested a total of \$75,000 aggregate face amount of the Summer 2009 Notes for an aggregate purchase price of \$75,000. The Summer 2009 Notes mature on the second anniversary of the closing of this offering and will be convertible, at the option of the noteholder, into up to 300,000 shares of common stock of the Company at a conversion price of \$0.25 per share.

Each of the investors in the Summer 2009 Offering will receive, for no additional consideration, a warrant (the "Summer 2009 Warrants"), entitling the holder to purchase a number of shares of our common stock equal to 100% of the number of shares of common stock into which the Summer 2009 Notes are convertible (the "Warrant Shares"). Each Summer 2009 Warrant is exercisable on a cash basis only at an initial price of \$0.30 per share, and is exercisable for a period of thirty six months. Up to 300,000 Warrant Shares are initially issuable on exercise of the Summer 2009 Warrants.

The outstanding balance at June 30, 2009 was \$75,000.

## Contractual Obligations

The following table discloses our contractual commitments for future periods. Long-term commitments are comprised of operating leases and minimum guaranteed compensation payments under employment and other agreements. (See Note 9 in Notes to Condensed Consolidated Financial Statements).

<b>Year ending December 31,</b>	<b>Operating Leases(1)</b>	<b>Guaranteed Payments</b>
2009	\$ 32,080	\$ 114,633 (2)
2010	\$ 43,560	\$ 142,567 (3)
2011	\$ —	\$ —
	<u>\$ 75,640</u>	<u>\$ 257,200</u>

(1) Consists of rent for our Morgan Hill Facility expiring on August 31, 2009 and Sta. Barbara office expiring December 31, 2010. (For description of this property, see Part 1, Item 2, "Property").

(2) Consists of total compensation, including base salary and certain contractually-provided benefits, to two executive officers, pursuant to employment agreements that expire on July 25, 2009 and January 30, 2010.

(3) Consists of an aggregate of \$17,567 in total compensation, including base salary and certain contractually provided benefits to one executive officer, pursuant to employment agreement that expires on January 30, 2010 and \$125,000 of license and maintenance fees due to Temple University.

### *License agreements with Temple University*

In 2007, we entered into three License Agreements with Temple University covering Temple University's current patent applications concerning certain electric field effects on gasoline, kerosene and diesel fuel particle size distribution, and concerning electric field effects on crude oil and edible oil viscosity. Initially, the License Agreements are exclusive and the territory licensed to us is worldwide. Pursuant to the License Agreements, we agreed to pay Temple University license fees in the aggregate amount of \$300,000 as follows: \$50,000 was due November 1, 2006, \$100,000 was due on March 2, 2007, \$75,000 was due February 2, 2008 and \$75,000 was due on February 2, 2009. Annual maintenance fees of \$25,000 for the first license were due on November 1, 2007 and November 1, 2008. Annual maintenance payments of \$125,000 for two of the licenses were due January 1, 2008. In addition, each License Agreement provides that we will pay royalties to Temple University on net sales of products incorporating such licensed technology.

We have also entered into a research and development agreement (R&D Agreement) with Temple University to conduct further research on the ELEKTRA technology. Under the R&D Agreement Temple University will conduct a 24-month research project towards expanding the scope of, and developing products utilizing, the technologies covered under the License Agreements. Pursuant to the R&D Agreement, we will make payments to Temple University in the aggregate amount of \$500,000.

At December 31, 2008, we were in default in the amount of \$716,500 under the License Agreements, maintenance fees, R & D Agreement and related penalties. On January 9, 2009, we entered into a Letter Agreement with Temple University wherein Temple University granted to us an extension of time to cure the above-referenced breaches until March 31, 2009. The Letter Agreement provides for payments of \$100,000 on January 31, 2009, \$100,000 on February 28, 2009 and \$100,000 on March 31, 2009. We made the January 31, 2009 payment but did not make the payment due on February 28, 2009. On March 26, 2009, we received a written extension for both the February 28, 2009 payment and the March 31, 2009 payment until April 30, 2009. All additional amounts past due as of November 10, 2008 were to be re-negotiated on or before March 31, 2009, however, this was been extended to April 30, 2009. All additional amounts past due as of December 31, 2008 and additional License and Maintenance Fees of \$200,000 which became due in the first quarter of 2009 were to be re-negotiated on or before April 30, 2009, however, this has now been extended to September 30, 2009. A penalty equal to 1% of the amount due and unpaid on the first day of each calendar month will be added to the outstanding amount due Temple University.

Fees due Temple University as of June 30, 2009 and 2008 were \$840,750 and \$418,250, respectively, and include all past due amounts and related penalties. During the six months ended June 30, 2009 and 2008, the Company recorded \$224,250, and \$316,750, respectively, of fees due to Temple University.

### **Critical Accounting Policies and Estimates**

Our discussion and analysis of our condensed consolidated financial condition and results of operations is based upon our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these condensed consolidated financial statements and related disclosures requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, expenses, and related disclosure of contingent assets and liabilities. We evaluate, on an on-going basis, our estimates and judgments, including those related to the useful life of the assets. We base our estimates on historical experience and assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The methods, estimates and judgments we use in applying our most critical accounting policies have a significant impact on the condensed consolidated results that we report in our financial statements. The SEC considers an entity's most critical accounting policies to be those policies that are both most important to the portrayal of a company's financial condition and results of operations and those that require management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about matters that are inherently uncertain at the time of estimation. For a more detailed discussion of the accounting policies of the Company, see Note 2 of Notes to the condensed consolidated financial statements.

We believe the following critical accounting policies, among others, require significant judgments and estimates used in the preparation of our condensed consolidated financial statements:

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Certain significant estimates were made in connection with preparing our condensed consolidated financial statements as described in Note 1 to Notes to condensed consolidated financial statements. Actual results could differ from those estimates

### **Revenue Recognition**

We have adopted Staff Accounting Bulletin 104, "Revenue Recognition" and therefore recognize revenue based upon meeting four criteria:

- Persuasive evidence of an arrangement exists;
- Delivery has occurred or services rendered;
- The seller's price to the buyer is fixed or determinable; and
- Collectability is reasonably assured.

We contract with manufactures of fixed magnetic field products and sell them to various original equipment manufacturers in the motor vehicle and small utility motor markets. We negotiate an initial contract with the customer fixing the terms of the sale and then receives a letter of credit or full payment in advance of shipment. Upon shipment, we recognize the revenue associated with the sale of the products to the customer.

### **Estimates**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Certain significant estimates were made in connection with preparing the Company's financial statements. Actual results could differ from those estimates.

## **Long-lived assets**

We account for the impairment and disposition of long-lived assets in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." In accordance with SFAS No. 144, long-lived assets to be held are reviewed for events or changes in circumstances that indicate that their carrying value may not be recoverable. We periodically review the carrying values of long-lived assets to determine whether or not impairment to such value has occurred. No impairments were recorded for the six months ended June 30, 2009. We recorded an impairment of approximately \$505,000 during the period from inception (February 18, 1998) through June 30, 2009.

## **Stock-Based Compensation**

We periodically issue stock options and warrants to employees and non-employees in capital raising transactions, for services and for financing costs. We adopted SFAS No. 123R effective January 1, 2006, and are using the modified prospective method in which compensation cost is recognized beginning with the effective date (a) based on the requirements of SFAS No. 123R for all share-based payments granted after the effective date and (b) based on the requirements of SFAS No. 123R for all awards granted to employees prior to the effective date of SFAS No. 123R that remain unvested on the effective date. We account for stock option and warrant grants issued and vesting to non-employees in accordance with EITF No. 96-18: "Accounting for Equity Instruments that are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services" and EITF No. 00-18 "Accounting Recognition for Certain Transactions Involving Equity Instruments Granted to Other Than Employees" whereas the value of the stock compensation is based upon the measurement date as determined at either a) the date at which a performance commitment is reached, or b) at the date at which the necessary performance to earn the equity instruments is complete.

## **Recent Accounting Pronouncements**

In December 2007, Financial Accounting Standards Board (FASB) Statement 141R, "Business Combinations (revised 2007)" (SFAS 141R) was issued. SFAS 141R replaces SFAS 141 "Business Combinations". SFAS 141R requires the acquirer of a business to recognize and measure the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree at fair value. SFAS 141R also requires transactions costs related to the business combination to be expensed as incurred. SFAS 141R applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The effective date, as well as the adoption date for the Company was January 1, 2009. Although SFAS 141R may impact our reporting in future financial periods, we have determined that the standard did not have any impact on our historical consolidated financial statements at the time of adoption.

In April 2008 the FASB issued FASB Staff Position ("FSP") No. 142-3, "Determination of the Useful Life of Intangible Assets" ("FSP 142-3"), which amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS 142. This pronouncement requires enhanced disclosures concerning a company's treatment of costs incurred to renew or extend the term of a recognized intangible asset. FST 142-3 is effective for financial statements issued for fiscal years beginning after December 15, 2008. The effective date, as well as the adoption date for the Company was January 1, 2009. Although FSP 142-3 may impact our reporting in future financial periods, we have determined that the standard did not have any impact on our historical consolidated financial statements at the time of adoption.

Other recent accounting pronouncements issued by the FASB (including its Emerging Issues Task Force), the AICPA, and the SEC did not or are not believed by management to have a material impact on the Company's present or future consolidated financial statements.

## **Item 3. Quantitative and Qualitative Disclosure about Market Risk**

The Company is a smaller reporting company and is not required to provide the information required by this.

## **Item 4. Controls and Procedures**

### ***Evaluation of Disclosure Controls and Procedures***

Our management evaluated, with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Report on Form 10-Q. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(b) under the Securities Exchange Act of 1934 (the "Exchange Act")) are not adequate to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms.

***Management's Annual Report on Internal Control over Financial Reporting.***

Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that (i) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transaction and dispositions of our assets; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

Because of its inherent limitation, internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives.

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as required in Rule 13a-15(b). In December 2006 our Controller retired and in January 2007 our Chief Financial Officer retired, although our former Controller still provides certain financial consulting services for us. We have hired an Interim Chief Financial Officer and a full-time Controller. We have retained a consulting firm and are conducting an evaluation to design and implement adequate systems of accounting and financial statement disclosure controls. We expect to complete this review during 2009 to comply with the requirements of the SEC. We believe that the ultimate success of our plan to improve our internal control over financial reporting will require a combination of additional financial resources, outside consulting services, legal advice, additional personnel, further reallocation of responsibility among various persons, and substantial additional training of those of our officers, personnel and others, including certain of our directors such as our Chairman of the Board and committee chairs, who are charged with implementing and/or carrying out our plan. It should also be noted that the design of any system of controls and procedures is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote.

Our annual report does not include an attestation report of our registered public accounting firm regarding internal control over financial reporting and management's report was not subject to attestation by our registered public accounting firm pursuant to temporary rules of the SEC that permit us to provide only Management's report in this annual report.

Other than as described above, there were no changes in our internal control over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## PART II

### Item 1. Legal Proceedings

On December 19, 2001, the SEC filed civil charges in the United States Federal District Court, Southern District of New York, against the Company, the Company's former President and then sole director Jeffrey A. Muller, and others, alleging that the Company and the other defendants were engaged in a fraudulent scheme to promote the Company's stock. The SEC complaint alleged the existence of a promotional campaign using press releases, Internet postings, an elaborate website, and televised media events to disseminate false and materially misleading information as part of a fraudulent scheme to manipulate the market for stock in the Company which was then controlled by Mr. Muller. On March 22, 2002, the Company signed a Consent to Final Judgment of Permanent Injunction and Other Relief in settlement of this action as against the corporation only, which the Court approved on July 2, 2002. Under this settlement, the Company was not required to admit fault and did not pay any fines or restitution.

On July 2, 2002, after an investigation by the Company's newly constituted board of directors, the Company filed a cross-complaint in the SEC action against Mr. Muller and others seeking injunctive relief, disgorgement of monies and stock and financial restitution for a variety of acts and omissions in connection with sales of the Company's stock and other transactions occurring between 1998 and 2002. Among other things, the Company alleged that Mr. Muller and certain others sold Company stock without providing adequate consideration to the Company; sold insider shares without making proper disclosures and failed to make necessary filing required under federal securities laws; engaged in self-dealing and entered into various undisclosed related-party transactions; misappropriated for their own use proceeds from sales of the Company's stock; and entered into various undisclosed arrangement regarding the control, voting and disposition of their stock.

On July 30, 2002, the U.S. Federal District Court, Southern District of New York, granted the Company's application for a preliminary injunction against Mr. Muller and others, which prevented Mr. Muller and other cross-defendants from selling, transferring, or encumbering any assets and property previously acquired from the Company, from selling or transferring any of the Company's stock that they may have owned or controlled, or from taking any action to injure the Company or the Company's business and from having any direct contact with the Company's shareholders. The injunctive order also prevented Mr. Muller or his nominees from engaging in any effort to exercise control over the Company's corporation and from serving as an officer or director of the Company.

In the course of the litigation, the Company has obtained ownership control over all patent rights to the ZEFS device.

On January 4, 2007, the Court entered a final judgment against Jeffrey Muller which barred Mr. Muller from serving as an officer or director of a public company for a period of 20 years, ordered Mr. Muller to disgorge any shares of the Company's stock that he still owns and directed the Company to cancel any issued and outstanding shares of the Company's stock still owned by Mr. Muller. Mr. Muller was also ordered to disgorge unlawful profits in the amount of \$7.5 million and to pay a civil penalty in the amount of \$100,000. Acting in accordance with the ruling and decision of the Court, the Company has canceled (i) 8,047,403 shares of common stock that had been held by Mr. Muller and/or his affiliates, (ii) options to acquire an additional 10,000,000 shares of the Company's common stock held by Mr. Muller personally and (iii) \$1,017,208 of debt which Mr. Muller claimed was owed to him by the Company. After an appeal filed by Mr. Muller was dismissed the Judgment against him is considered final.

On February 8, 2007, Federal Magistrate Judge Maas issued a post-judgment order, at the Company's request, which further concluded that all of the shares of the Company's stock held by Mr. Muller or any of his nominees directly or indirectly owned or controlled were to be recaptured by the Company and were subject to disgorgement and forfeiture. The ruling provided that all shares, options and any other obligations allegedly owed by the Company to Mr. Muller were to be disgorged in our favor and confirmed the earlier judgment holding Mr. Muller liable for \$7.5 million in actual damages, imposing a \$100,000 fine and barring Mr. Muller from any involvement with a publicly traded company for 20 years. With prejudgment interest, this ruling brings the actual damages against Muller to over \$11 million. Additionally, the Court clarified that the order required the disgorgement of any shares of the Company's stock that Mr. Muller or any of his nominees directly or indirectly owned or controlled. In furtherance of this order, the Company has taken action to cancel over 3.6 million shares which had been issued to offshore companies. The Order also confirmed the appropriateness of actions previously taken by the Company to acquire the patent rights and to consolidate the manufacturing, marketing and distribution rights with its ownership of all rights to the existing patents. On February 11, 2009, Judge Maas confirmed that his previous decision was modified and Save the World Air's Motion for Summary Judgment was granted in favor of Save the World Air as set forth in his order of February 8, 2007. A proposed Final Judgment in favor of Save the World Air is pending before the United States District Court, Southern District of New York

#### *Litigation Involving Scottish Glen Golf Company*

We were involved in litigation with Scottish Glen Golf Company, Inc. (SGGC) doing business as KZ Golf, Inc., our previous landlord on claims in the aggregate amount of \$104,413. We did not dispute the fact that certain amounts of unpaid past rent are due but did dispute that we owe the aggregate of \$104,413 demanded by SGGC; more than half of which are purported "late fees" which was assessed at the rate of \$100 per day. It was our position that the late fees are void and unenforceable and that we are entitled to a set-off for office space that reverted back to SGGC.

On April 30, 2008 we and SGGC settled our pending litigation relating to our prior offices. We paid to SGGC \$51,000 in full settlement of SGGC's claims. On May 28, 2008 the initial payment of \$34,000 was made and on July 9, 2008 the final payment of \$17,000 was made and the Complaint was dismissed, with prejudice. We recorded \$52,069 as other income and as a reduction of accounts payable.

## **Item 1A. Risk Factors**

There have been no material changes in the risk factors previously disclosed in Form 10-K we filed with the SEC on March 31, 2009.

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

### ***Morale Orchards Transaction***

On December 5, 2006, we entered into a Note Purchase Agreement (the "Note Purchase Agreement") with Morale Orchards, LLC ("Morale"). The Note Purchase Agreement provides that Morale will purchase the Company's one-year Convertible Promissory Notes in the aggregate face amount of \$1,225,000 (the "Morale Notes"), and five-year Warrants (the "Morale Warrants") to purchase shares of our Common Stock at prices ranging from \$0.70 to \$0.85 per share. The aggregate purchase price for the Morale Notes and Morale Warrants is \$1,000,000. Therefore, while the stated interest on the Morale Notes is 0%, the actual interest rate is 22.5% because the Morale Notes are being purchased at a discount from their face amount.

Pursuant to the terms of the Note Purchase Agreement, Morale purchased one Morale Note in the principal amount of \$612,500 on December 5, 2006, for which it paid \$500,000 and purchased the other Morale Note in the principal amount of \$612,500 on January 10, 2007, for which it paid \$500,000. The December 5, 2006 Note is convertible into 720,588 shares of our common stock and 360,294 Warrants to purchase our common stock were issued. The January 10, 2007 Note is convertible into 875,000 shares of our common stock and 437,500 Warrants to purchase our common stock were issued. (See "Details of Recent Financing Transactions").

On January 31, 2008, a Modification and Satisfaction Agreement was entered into between the Company, Morale Orchards, LLP and Matthews & Partners. (See "Details of Recent Financing Transactions").

### ***2007 Winter Offering***

From December 27, 2008 through February 29, 2008, we conducted a private offering (the "2007 Winter Offering") and issued Convertible Notes in the aggregate face amount of \$521,400. These Notes were sold for an aggregate purchase price of \$474,000 net proceeds. The Notes are convertible into 1,042,800 shares of our common stock and in addition, investors received warrants entitling the holders to purchase up to 521,400 shares of our common stock. (See "Details of Recent Financing Transactions").

### ***2008 Spring Offering***

On May 27, 2008 we conducted a private offering (the "2008 Spring Offering") and issued a Convertible Note in the aggregate face amount of \$66,000. This note was sold for an aggregate purchase price of \$60,000 net proceeds. The Note is convertible in to 132,000 shares of our common stock and in addition, the investor received warrants entitling the holder to purchase up to 66,000 shares of our common stock. (See "Details of Recent Financing Transactions").

### ***2008 Summer Offering***

From July 17, 2008 through August 31, 2008, we conducted a private offering (the "2008 Summer Offering") and issued Convertible Notes in the aggregate face amount of \$484,000. These Notes were sold for an aggregate purchase price of \$440,000 net proceeds. The Notes are convertible into 1,423,530 shares of our common stock and in addition, investors received warrants entitling the holders to purchase up to 711,764 shares of our common stock. (See "Details of Recent Financing Transactions").

### ***2008 Winter Offering***

From November 24, 2008 through December 5, 2008, the we conducted a private offering (the "2008 Winter Offering") and issued Convertible Notes in the aggregate face amount of \$524,700. These Notes were sold for an aggregate purchase price of \$477,000 net proceeds. The Notes are convertible into 3,086,470 shares of our common stock and in addition, investors received warrants entitling the holders to purchase up to 1,543,235 shares of our common stock. (See "Details of Recent Financing Transactions").



### ***2009 Winter Offering I***

From January 13, 2009 through January 26, 2009, we conducted a private offering (the “2009 Winter Offering I”) and issued Convertible Notes in the aggregate face amount of \$250,000. These Notes were sold for an aggregate purchase price of \$250,000 net proceeds. The Notes are convertible into 699,444 shares of our common stock and in addition, investors received warrants entitling the holders to purchase up to 347,722 shares of our common stock. (See “Details of Recent Financing Transactions”).

### ***2009 Winter Offering II***

From February 4, 2009 through March 11, 2009, we conducted a private offering (the “2009 Winter Offering II”) and issued Convertible Notes in the aggregate face amount of \$247,302. These Notes were sold for an aggregate purchase price of \$224,820 net proceeds. The Notes are convertible into 772,818 shares of our common stock and in addition, investors received warrants entitling the holders to purchase up to 386,409 shares of our common stock. (See “Details of Recent Financing Transactions”).

### ***2009 Spring Offering***

From March 17, 2009 through April 30, 2009, we conducted a private offering (the “2009 Winter Spring”) and issued Convertible Notes in the aggregate face amount of \$181,500. These Notes were sold for an aggregate purchase price of \$165,000 net proceeds. The Notes are convertible into 672,222 shares of our common stock and in addition, investors received warrants entitling the holders to purchase up to 336,111 shares of our common stock. (See “Details of Recent Financing Transactions”).

### ***2009 Summer Offering***

On June 9, 2009, we began conducting a private offering (the “Summer 2009 Offering”) of up to \$500,000 aggregate face amount of our convertible notes (the “Summer 2009 Notes”) with interest compounded quarterly at the annual rate of seven percent (7%) payable at maturity. As of June 30, 2009, 4 accredited investors had invested a total of \$75,000 aggregate face amount of the Summer 2009 Notes for an aggregate purchase price of \$75,000. (See “Details of Recent Financing Transactions”).

The sales of the securities described above were made in reliance on the exemptions from registration set forth in Section 4(2) of the Securities Act of 1933, as amended (the “Act”), or Regulations D or S promulgated thereunder.

### ***Other Issuances.***

During the six months ended June 30, 2009, we issued 1,917,855 shares of common stock in exchange for conversion of \$416,000 of Convertible Notes.

During the six months ended June 30, 2009, we issued 502,355 shares of common stock in exchange for services in the amount of \$174,413.

### **Item 3. Defaults Upon Senior Securities**

None

### **Item 4. Submission of Matters to a Vote of Security Holders**

None

**Item 5. Other Information**

On April 29, 2009, the Company received from Temple University a written extension of the January 9, 2009 Letter Agreement. The agreement provides an extension of the \$100,000 due to Temple on February 28, 2009 and \$100,000 due March 30, 2009 to May 29, 2009. The Company expects that all payments regarding past due amounts, with the exception of the prescribed payments, will be renegotiated on or before May 29, 2009. On August 12, 2009 the Company received an extension until September 30, 2009.

Subsequent to June 30, 2009, we has received from 2 accredited investors a total of \$50,000 which will be convertible, at the option of the noteholders, into up to 125,000 shares of the our common stock and for no additional consideration a warrant will be issued entitling the holder to purchase 125,000a of shares of our common stock. The original closing date of June 30, 2009 has been extended to August 31, 2009.

In August, 2009, an officer and director advanced us \$13,500 repayable upon demand.

**Item 6. Exhibits**

<u>Exhibit No.</u>	<u>Description</u>
31.1	Certification of Chief Executive Officer of Quarterly Report Pursuant to Rule 13(a)-15(e) or Rule 15(d)-15(e)
31.2	Certification of Chief Financial Officer of Quarterly Report Pursuant to 18 U.S.C. Section 1350
32	Certification of Chief Executive Officer and Chief Financial Officer of Quarterly Report pursuant to Rule 13(a)-15(e) or Rule 15(d)-15(e)

## SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the Registrant has caused this Report to be signed on its behalf by the undersigned, hereunto duly authorized.

SAVE THE WORLD AIR, INC.

Date: August 14, 2009

By: /s/ EUGENE E. EICHLER  
Eugene E. Eichler  
Interim Chief Financial Officer

## EXHIBIT INDEX

<u>Exhibit No.</u>	<u>Description</u>
31.1	Certification of Chief Executive Officer of Quarterly Report Pursuant to Rule 13(a)-15(e) or Rule 15(d)-15(e)
31.2	Certification of Chief Financial Officer of Quarterly Report Pursuant to 18 U.S.C. Section 1350
32	Certification of Chief Executive Officer and Chief Financial Officer of Quarterly Report pursuant to Rule 13(a)-15(e) or Rule 15(d)-15(e)



**CERTIFICATION OF CHIEF EXECUTIVE OFFICER  
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002  
AND RULES 13A-14 AND 15D-14 UNDER THE SECURITIES EXCHANGE ACT OF 1934**

I, Cecil Bond Kyte, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Save the World Air, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e) and internal control over financial reporting) as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its condensed consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 12 , 2009

/s/ CECIL BOND KYTE

Cecil Bond Kyte  
Chief Executive Officer



**CERTIFICATION OF CHIEF FINANCIAL OFFICER  
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002  
AND RULES 13A-14 AND 15D-14 UNDER THE SECURITIES EXCHANGE ACT OF 1934**

I, Eugene E. Eichler, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Save the World Air, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e) and internal control over financial reporting) as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the registrant and have :

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its condensed consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 12, 2009

/s/ EUGENE E. EICHLER

Eugene E. Eichler  
Interim Chief Financial Officer





**CERTIFICATION OF PERIODIC FINANCIAL REPORT BY THE CHIEF EXECUTIVE  
OFFICER AND CHIEF FINANCIAL OFFICER  
PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

Solely for the purposes of complying with 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, we, the undersigned Acting Chief Executive Officer and the Chief Financial Officer of Save the World Air, Inc. (the "Company"), hereby certify, based on our knowledge, that the Quarterly Report on Form 10-Q of the Company for the quarter ended June 30, 2009 (the "Report") fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934 and that the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 14, 2009

/s/ CECIL BOND KYTE

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Cecil Bond Kyte  
Chief Executive Officer

Date: August 14, 2009

/s/ EUGENE E. EICHLER

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Eugene E. Eichler  
Interim Chief Financial Officer

