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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-QSB

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

For the quarterly period ended March 31, 2007

or

o **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	**52-2088326**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*

5125 Lankershim Boulevard
North Hollywood, California 91601
(Address, including zip code, of principal executive offices)

(818) 487-8000
(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 o No þ

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

The number of shares of the Registrant's Common Stock outstanding as of June 29, 2007 was 41,962,178 shares.

Transitional Small Business Disclosure Format (Check one): Yes o No þ

SAVE THE WORLD AIR, INC.

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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
MARCH 31, 2007 (UNAUDITED) AND DECEMBER 31, 2006

	March 31, 2007 (unaudited)	December 31, 2006
ASSETS		
Current assets		
Cash	$ 92,336	$ 244,228
Inventory	25,722	21,314
Other current assets	94,143	81,232
Total current assets	212,201	346,774
Property and equipment, net of accumulated depreciation	307,128	322,023
Other assets	4,500	4,500
Total assets	$ 523,829	$ 673,297

See notes to condensed consolidated financial statements.

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

CONDENSED CONSOLIDATED BALANCE SHEETS — Continued
MARCH 31, 2007 (UNAUDITED) AND DECEMBER 31, 2006

	March 31, 2007 (unaudited)	December 31, 2006
LIABILITIES AND STOCKHOLDERS' DEFICIENCY		
Current liabilities		
Accounts payable	$ 412,518	$ 233,707
Accrued expenses	473,043	468,413
Accrued research and development fees	95,000	95,000
Accrued professional fees	687,526	594,945
Convertible debentures, net	660,623	177,926
Total current liabilities	2,328,710	1,569,991
Commitments and contingencies		
Stockholders' deficiency		
Common stock, $.001 par value: 200,000,000 shares authorized, 40,687,707 and 40,081,758 shares issued and outstanding at March 31, 2007 and December 31, 2006, respectively	40,688	40,082
Common stock to be issued	60,000	60,000
Additional paid-in capital	30,436,189	29,430,821
Deficit accumulated during the development stage	(32,341,758)	(30,427,597)
Total stockholders' deficiency	(1,804,881)	(896,694)
Total liabilities and stockholders' deficiency	$ 523,829	$ 673,297

See notes to condensed consolidated financial statements.

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

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)
THREE MONTHS ENDED MARCH 31, 2007 AND 2006 AND FOR THE PERIOD FEBRUARY 18, 1998 (DATE OF INCEPTION) TO MARCH 31, 2007

	March 31, 2007	March 31, 2006	Cumulative since inception
Net sales	$ 22,000	$ —	$ 52,000
Cost of goods sold	5,360	—	18,760
Gross profit	16,640	—	33,240
Operating expenses	1,279,775	1,755,438	24,182,751
Research and development expenses	340,452	57,294	4,545,866
Non-cash patent settlement cost	—	—	1,610,066
Loss before other income(expense)	(1,603,587)	(1,812,732)	(30,305,443)
Other income(expense)			
Other income	87	—	212
Interest income	17	—	16,268
Interest expense	(207,672)	(1,184,573)	(2,963,515)
Financing fee	(47,104)	—	(47,104)
Placement fee	(42,000)	—	(42,000)
Other expense	(13,102)		(13,102)
Settlement of litigation and debt	—	—	1,017,208
Loss before provision for income taxes	(1,913,361)	(2,997,305)	(32,337,476)
Provision for income taxes	800	800	4,282
Net loss	$ (1,914,161)	$ (2,998,105)	$(32,341,758)
Net loss per common share, basic and diluted	$ (0.05)	$ (0.10)	
Weighted average common shares outstanding, basic and diluted	39,012,446	31,468,333	

See notes to condensed consolidated financial statements.

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

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIENCY
FEBRUARY 18, 1998 (DATE OF INCEPTION) TO MARCH 31, 2007

	Common Stock		Common stock to be issued	Additional paid-in capital	Deferred compensation	Deficit accumulated during the development stage	Total stockholders' development stage deficiency
	Shares	Amount					
Balance, February 18, 1998 (date of inception)	—	$ —	$ —	$ —	$ —	$ —	$ —
Issuance of common stock on April 18, 1998	10,030,000	10,030	—	14,270	—	—	24,300
Net loss	—	—	—	—	—	(21,307)	(21,307)
Balance, December 31, 1998	**10,030,000**	**10,030**		**14,270**	**—**	**(21,307)**	**2,993**
Issuance of common stock on May 18, 1999	198,003	198	—	516,738	—	—	516,936
Issuance of common stock for ZEFS on September 14, 1999	5,000,000	5,000	—	—	—	—	5,000
Stock issued for professional services on May 18, 1999	69,122	69	—	49,444	—	—	49,513
Net loss	—	—	—	—	—	(1,075,264)	(1,075,264)
Balance, December 31, 1999	**15,297,125**	**15,297**	**—**	**580,452**	**—**	**(1,096,571)**	**(500,822)**
Stock issued for employee compensation on February 8, 2000	20,000	20	—	20,580	—	—	20,600
Stock issued for consulting services on February 8, 2000	100,000	100	—	102,900	—	—	103,000
Stock issued for professional services on April 18, 2000	27,000	27	—	91,233	—	—	91,260
Stock issued for directors fees on April 18, 2000	50,000	50	—	168,950	—	—	169,000
Stock issued for professional services on May 19, 2000	5,000	5	—	20,295	—	—	20,300
Stock issued for directors fees on June 20, 2000	6,000	6	—	26,634	—	—	26,640
Stock issued for professional services on June 20, 2000	1,633	2	—	7,249	—	—	7,251

Stock issued for professional services on June 26, 2000	1,257	1	—	6,674	—	—	6,675
Stock issued for employee compensation on June 26, 2000	22,000	22	—	116,798	—	—	116,820
Stock issued for consulting services on June 26, 2000	9,833	10	—	52,203	—	—	52,213
Stock issued for promotional services on July 28, 2000	9,675	9	—	47,205	—	—	47,214
Stock issued for consulting services on July 28, 2000	9,833	10	—	47,975	—	—	47,985
Stock issued for consulting services on August 4, 2000	35,033	35	—	74,585	—	—	74,620
Stock issued for promotional services on August 16, 2000	25,000	25	—	56,225	—	—	56,250
Stock issued for consulting services on September 5, 2000	12,833	13	—	28,861	—	—	28,874
Stock issued for consulting services on September 10, 2000	9,833	10	—	14,740	—	—	14,750
Stock issued for consulting services on November 2, 2000	9,833	10	—	8,643	—	—	8,653

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

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIENCY — Continued
FEBRUARY 18, 1998 (DATE OF INCEPTION) TO MARCH 31, 2007

	Common Stock		Common stock to be issued	Additional paid-in capital	Deferred compensation	Deficit accumulated during the development stage	Total stockholders' development stage deficiency
	Shares	Amount					
Stock issued for consulting services on November 4, 2000	9,833	10	—	8,643	—	—	8,653
Stock issued for consulting services on December 20, 2000	19,082	19	—	9,522	—	—	9,541
Stock issued for filing services on December 20, 2000	5,172	5	—	2,581	—	—	2,586
Stock issued for professional services on December 26, 2000	12,960	13	—	4,912	—	—	4,925
Other stock issuance on August 24, 2000	2,000	2	—	4,258	—	—	4,260
Common shares cancelled	(55,000)	(55)	—	(64,245)	—	—	(64,300)
Net loss	—	—	—	—	—	(1,270,762)	(1,270,762)
Balance, December 31, 2000	**15,645,935**	**15,646**	**—**	**1,437,873**	**—**	**(2,367,333)**	**(913,814)**
Stock issued for consulting services on January 8, 2001	9,833	10	—	3,038	—	—	3,048
Stock issued for consulting services on February 1, 2001	9,833	10	—	3,235	—	—	3,245
Stock issued for consulting services on March 1, 2001	9,833	10	—	2,743	—	—	2,753
Stock issued for legal services on March 13, 2001	150,000	150	—	47,850	—	—	48,000
Stock issued for consulting services on April 3, 2001	9,833	10	—	2,448	—	—	2,458
Stock issued for legal services on April 4, 2001	30,918	31	—	7,699	—	—	7,730
Stock issued for professional services on							

April 4, 2001	7,040	7	—	1,753	—	—	1,760
Stock issued for consulting services on April 5, 2001	132,600	132	—	33,018	—	—	33,150
Stock issued for filing fees on April 30, 2001	1,233	1	—	2,033	—	—	2,034
Stock issued for filing fees on September 19, 2001	2,678	2	—	2,274	—	—	2,276
Stock issued for professional services on September 28, 2001	150,000	150	—	92,850	—	—	93,000
Stock issued for directors services on October 5, 2001	100,000	100	—	59,900	—	—	60,000
Stock issued for legal services on October 17, 2001	11,111	11	—	6,655	—	—	6,666
Stock issued for consulting services on October 18, 2001	400,000	400	—	379,600	—	—	380,000
Stock issued for consulting services on October 19, 2001	150,000	150	—	187,350	—	—	187,500
Stock issued for exhibit fees on October 22, 2001	5,000	6	—	6,745	—	—	6,751
Stock issued for directors services on November 2, 2001	1,000,000	1,000	—	949,000	—	—	950,000
Stock issued for consulting services on November 7, 2001	20,000	20	—	16,980	—	—	17,000

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

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIENCY — Continued
FEBRUARY 18, 1998 (DATE OF INCEPTION) TO MARCH 31, 2007

	Common Stock		Common stock to be issued	Additional paid-in capital	Deferred compensation	Deficit accumulated during the development stage	Total stockholders' development stage deficiency
	Shares	Amount					
Stock issued for consulting services on November 20, 2001	43,000	43	—	42,097	—	—	42,140
Stock issued for consulting services on November 27, 2001	10,000	10	—	9,790	—	—	9,800
Stock issued for consulting services on November 28, 2001	187,000	187	—	183,073	—	—	183,260
Intrinsic value of options issued to employees	—	—	—	2,600,000	(2,600,000)	—	—
Fair value of options issued to non-employees for services	—	—	—	142,318	—	—	142,318
Amortization of deferred compensation	—	—	—	—	191,667	—	191,667
Net loss	—	—	—	—	—	(2,735,013)	(2,735,013)
Balance, December 31, 2001	**18,085,847**	**18,086**	**—**	**6,220,322**	**(2,408,333)**	**(5,102,346)**	**(1,272,271)**
Stock issued for directors services on December 10, 2002	2,150,000	2,150	—	857,850	—	—	860,000
Common stock paid for, but not issued (2,305,000 shares)	—	—	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 for the year ended December 31, 2002	—	—	—	—	—	(2,749,199)	(2,749,199)
Balance, December 31,							

2002	**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	1,425,000	1,425	(213,750)	212,325	—	—	—
Common stock issued, previously paid for	880,000	880	(220,000)	219,120	—	—	—
Stock issued for cash on March 20, 2003	670,000	670	—	166,830	—	—	167,500
Stock issued for cash on April 4, 2003	900,000	900	—	224,062	—	—	224,962
Stock issued for cash on April 8, 2003	100,000	100	—	24,900	—	—	25,000
Stock issued for cash on May 8, 2003	1,150,000	1,150	—	286,330	—	—	287,480
Stock issued for cash on June 16, 2003	475,000	475	—	118,275	—	—	118,750
Stock issued for legal services on June 27, 2003	83,414	83	—	45,794	—	—	45,877
Debt converted to stock on June 27, 2003	2,000,000	2,000	—	498,000	—	—	500,000
Stock and warrants issued for cash on July 11, 2003	519,000	519	—	129,231	—	—	129,750
Stock and warrants issued for cash on September 29, 2003	1,775,000	1,775	—	441,976	—	—	443,751
Stock and warrants issued for cash on October 21, 2003	1,845,000	1,845	—	459,405	—	—	461,250
Stock and warrants issued for cash on October 28, 2003	1,570,000	1,570	—	390,930	—	—	392,500
Stock and warrants issued for cash on November 19, 2003	500,000	500	—	124,500	—	—	125,000

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

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIENCY — Continued
FEBRUARY 18, 1998 (DATE OF INCEPTION) TO MARCH 31, 2007

	Common Stock		Common stock to be issued	Additional paid-in capital	Deferred compensation	Deficit accumulated during the development stage	Total stockholders' development stage deficiency
	Shares	Amount					
Finders' fees related to stock issuances	—	—	43,875	(312,582)	—	—	(268,707)
Common stock paid for, but not issued (25,000 shares)	—	—	6,250	—	—	—	6,250
Amortization of deferred comp	—	—	—	—	863,727	—	863,727
Net loss for year ended December 31, 2003	—	—	—	—	—	(2,476,063)	(2,476,063)
Balance, December 31, 2003	**34,128,261**	**34,128**	**6,250**	**10,162,177**	**(708,333)**	**(10,327,608)**	**(833,386)**
Common stock issued, previously paid for	25,000	25	(6,250)	6,225	—	—	—
Stock issued for director services on March 31, 2004	50,000	50	—	74,950	—	—	75,000
Stock issued for finders fees on March 31, 2004	82,500	82	—	12,293	—	—	12,375
Stock issued for finders fees on March 31, 2004	406,060	407	—	101,199	—	—	101,606
Stock issued for services on April 2, 2004	65,000	65	—	99,385	—	—	99,450
Debt converted to stock on April 2, 2004	60,000	60	—	91,740	—	—	91,800
Stock issued upon exercise of warrants on May 21, 2004	950,000	950	—	189,050	—	—	190,000
Stock issued for directors services on June 8, 2004	600,000	600	—	1,019,400	—	—	1,020,000
Stock issued for cash on August 25, 2004	550,000	550	—	549,450	—	—	550,000
Stock issued upon exercise of options on							

August 30, 2004	4,000	4	—	1,596	—	—	1,600
Stock issued for cash on September 8, 2004	25,000	25	—	24,975	—	—	25,000
Stock issued for consulting services on September 15, 2004	50,000	49	—	65,451	—	—	65,500
Stock issued for patent settlement on September 22, 2004	20,000	20	—	24,780	—	—	24,800
Stock issued for research and development on October 6, 2004	65,000	65	—	90,935	—	—	91,000
Stock issued for cash on October 6, 2004	25,000	25	—	24,975	—	—	25,000
Stock issued for cash on October 15, 2004	150,000	150	—	149,850	—	—	150,000
Stock issued upon exercise of stock options on October 21, 2004	6,500	6	—	2,594	—	—	2,600
Stock issued for cash on November 3, 2004	25,000	25	—	24,975	—	—	25,000
Stock issued for cash on November 18, 2004	172,500	173	—	172,327	—	—	172,500
Stock issued for cash on December 9, 2004	75,000	75	—	74,925	—	—	75,000
Stock issued for cash on December 23, 2004	250,000	250	—	249,750	—	—	250,000
Finders fees related to stock issuances	—	—	—	(88,384)	—	—	(88,384)
Common stock paid for, but not issued (119,000 shares)	—	—	119,000	—	—	—	119,000
Intrinsic value of options issued to employees	—	—	—	248,891	(248,891)	—	—

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

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIENCY — Continued
FEBRUARY 18, 1998 (DATE OF INCEPTION) TO MARCH 31, 2007

	Common Stock		Common stock to be issued	Additional paid-in capital	Deferred compensation	Deficit accumulated during the development stage	Total stockholders' development stage deficiency
	Shares	Amount					
Fair value of options issued to non-employees for services	—	—	—	55,381	(55,381)	—	—
Fair value of warrants issued for settlement costs	—	—	—	1,585,266	—	—	1,585,266
Fair value of warrants issued to non-employees for services	—	—	—	28,872	—	—	28,872
Amortization of deferred compensation	—	—	—	—	936,537	—	936,537
Net loss for year ended December 31, 2004	—	—	—	—	—	(6,803,280)	(6,803,280)
Balance, December 31, 2004	**37,784,821**	**37,784**	**119,000**	**15,043,028**	**(76,068)**	**(17,130,888)**	**(2,007,144)**
Common stock issued, previously paid for	69,000	69	(69,000)	68,931	—	—	—
Stock issued upon exercise of warrants, previously paid for	50,000	50	(50,000)	49,950	—	—	—
Stock issued for cash on January 20, 2005	25,000	25	—	24,975	—	—	25,000
Stock issued upon exercise of warrants on January 31, 2005	500	1	—	199	—	—	200
Stock issued for cash on February 17, 2005	325,000	325	—	324,675	—	—	325,000
Stock issued for cash on March 31, 2005	215,000	215	—	214,785	—	—	215,000
Stock issued for cash on May 17, 2005	5,000	5	—	4,995	—	—	5,000

Stock issued for cash on June 7, 2005	300,000	300	—	299,700	—	—	300,000
Stock issued for cash on August 5, 2005	480,500	480	—	480,020	—	—	480,500
Stock issued for cash on August 9, 2005	100,000	100	—	99,900	—	—	100,000
Stock issued for cash on October 27, 2005	80,000	80	—	79,920	—	—	80,000
Common stock cancelled on December 7, 2005	(8,047,403)	(8,047)	—	8,047	—	—	—
Stock issued for settlement of payables on December 21, 2005	—	—	57,092	—	—	—	57,092
Stock issued for settlement of payables on December 31, 2005	—	—	555,429	—	—	—	555,429
Finders fees related to stock issuances	—	—	—	(109,840)	—	—	(109,840)
Intrinsic value of options issued to employees	—	—	—	243,750	(243,750)	—	—
Fair value of options issued for settlement costs	—	—	—	31,500	—	—	31,500
Fair value of warrants issued for settlement costs	—	—	—	4,957	—	—	4,957
Fair value of warrants issued to non-employees for services	—	—	—	13,505	—	—	13,505
Amortization of deferred compensation	—	—	—	—	177,631	—	177,631
Warrants issued with convertible notes	—	—	—	756,768	—	—	756,768
Intrinsic value of beneficial conversion associated with convertible notes	—	—	—	696,413	—	—	696,413
Net loss for year ended December 31, 2005	—	—	—	—	—	(3,115,186)	(3,115,186)

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

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIENCY — Continued
FEBRUARY 18, 1998 (DATE OF INCEPTION) TO MARCH 31, 2007

	Common Stock		Common stock to be issued	Additional paid-in capital	Deferred compensation	Deficit accumulated during the development stage	Total stockholders' development stage deficiency
	Shares	Amount					
Balance, December 31, 2005	**31,387,418**	**$31,387**	**$ 612,521**	**$18,336,178**	**$ (142,187)**	**$(20,246,074)**	**$ (1,408,175)**
Stock issued, for previously settled payables	846,549	847	(612,521)	611,674	—	—	—
Stock issued upon exercise of warrants on March 23, 2006	25,000	25	—	37,475	—	—	37,500
Stock issued upon exercise of warrants on March 27, 2006	50,000	50	—	74,950	—	—	75,000
Stock issued upon exercise of warrants on March 27, 2006	25,000	25	—	12,475	—	—	12,500
Stock issued upon exercise of warrants on March 30, 2006	10,000	10	—	9,990	—	—	10,000
Stock issued upon exercise of warrants on April 10, 2006	36,250	36	—	18,089	—	—	18,125
Common stock issued for convertible debt on April 10, 2006	269,600	270	—	188,450	—	—	188,720
Stock issued for cash on April 24, 2006	473,000	473	—	737,408	—	—	737,881
Stock issued upon exercise of warrants on April 26, 2006	125,000	125	—	62,375	—	—	62,500
Stock issued							

upon exercise of warrants on April 26, 2006	100,000	100	—	149,900	—	—	150,000
Common stock issued for convertible debt on April 26, 2006	35,714	36	—	24,964	—	—	25,000
Stock issued upon exercise of warrants on May 6, 2006	200,000	200	—	99,800	—	—	100,000
Stock issued upon exercise of warrants on May 15, 2006	25,000	25	—	37,475	—	—	37,500
Stock issued upon exercise of warrants on May 15, 2006	50,000	50	—	24,950	—	—	25,000
Stock issued for cash on June 7, 2006	873,018	872	—	1,649,136	—	—	1,650,008
Common stock issued for convertible debt on June 7, 2006	1,535,716	1,536	—	1,073,464	—	—	1,075,000
Stock issued upon exercise of warrants on June 8, 2006	900,000	900	—	449,100	—	—	450,000
Stock issued upon exercise of warrants on June 9, 2006	9,000	9	—	4,491	—	—	4,500
Stock issued upon exercise of warrants on June 23, 2006	150,000	150	—	74,850	—	—	75,000
Stock issued upon exercise of warrants on June 23, 2006	15,000	15	—	22,485	—	—	22,500
Common stock issued for convertible debt on June 30, 2006	219,104	219	—	153,155	—	—	153,374
Common stock issued for convertible debt on July 11, 2006	14,603	15	—	10,207	—	—	10,222
Common stock							

issued for convertible debt on August 7, 2006	1,540,160	1,540	—	1,076,572	—	—	1,078,112
Common stock issued upon exercise of warrants on August 7, 2006	175,000	175	—	262,325	—	—	262,500
Common stock issued upon exercise of warrants on August 21, 2006	50,000	50	—	74,950	—	—	75,000

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

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIENCY — Continued
FEBRUARY 18, 1998 (DATE OF INCEPTION) TO MARCH 31, 2007

	Common Stock		Common stock to be issued	Additional paid-in capital	Deferred compensation	Deficit accumulated during the development stage	Total stockholders' development stage deficiency
	Shares	Amount					
Common stock issued for cash on August 22, 2006	14,519	15	—	14,504	—	—	14,519
Common stock issued upon exercise of warrants on August 23, 2006	3,683	4	—	3,679	—	—	3,683
Common stock issued upon exercise of warrants on August 28, 2006	5,000	5	—	7,495	—	—	7,500
Common stock issued for convertible debt on September 13, 2006	4,286	4	—	2,996	—	—	3,000
Common stock issued upon exercise of warrants on September 13, 2006	150,000	150	—	74,850	—	—	75,000
Common stock issued for convertible debt on October 16, 2006	66,654	67	—	46,591	—	—	46,658
Common stock issued upon exercise of warrants on November 3, 2006	210,000	210	—	104,790	—	—	105,000
Common stock issued for put on equity line of credit on November 7, 2006	94,470	94	—	115,368	—	—	115,462
Common stock issued for put on equity line of credit on November 14, 2006	7,300	7	—	8,349	—	—	8,356
Common stock issued for put on equity line of credit on November 27,							

2006	27,500	28	—	22,913	—	—	22,941
Common stock issued for put on equity line of credit on November 28, 2006	36,500	36	—	30,059	—	—	30,095
Common stock issued for put on equity line of credit on December 6, 2006	73,863	74	—	57,244	—	—	57,318
Common stock issued for put on equity line of credit on December 26, 2006	18,800	19	—	10,377	—	—	10,396
Common stock issued for put on equity line of credit on December 31, 2006	229,050	229	—	135,300	—	—	135,529
Common stock paid for, but not issued	—	—	60,000	—	—	—	60,000
Fair value of options issued to employees and officers	—	—	—	2,253,263	—	—	2,253,263
Fair value of warrants issued for services	—	—	—	401,130	—	—	401,130
Write off of deferred compensation	—	—	—	(142,187)	142,187	—	—
Warrants issued for consulting services	—	—	—	62,497	—	—	62,497
Warrants issued with convertible notes	—	—	—	408,596	—	—	408,596
Intrinsic value of beneficial conversion associated with convertible notes	—	—	—	851,100	—	—	851,100
Finders fees related to stock issuances	—	—	—	(284,579)	—	—	(284,579)
Fees paid on equity line of credit	—	—	—	(30,402)	—	—	(30,402)
Net loss for year ended December 31, 2006	—	—	—	—	—	(10,181,523)	(10,181,523)

SAVE THE WORLD AIR, INC. AND SUBSIDIARY
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CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIENCY — Continued
FEBRUARY 18, 1998 (DATE OF INCEPTION) TO MARCH 31, 2007

	Common Stock		Common stock to be issued	Additional paid-in capital	Deferred compensation	Deficit accumulated during the development stage	Total stockholders' development stage deficiency
	Shares	Amount					
Balance, December 31, 2006	**40,081,757**	**$40,082**	**$ 60,000**	**$29,430,821**	**$ —**	**$(30,427,597)**	**$ (896,694)**
Common stock issued for put on equity line of credit on January 11, 2007	63,000	63	—	39,659	—	—	39,722
Common stock issued for put on equity line of credit on January 22, 2007	58,150	58	—	42,246	—	—	42,304
Common stock issued for put on equity line of credit on February 9, 2007	35,800	36	—	26,009	—	—	26,045
Common stock issued for put on equity line of credit on February 16, 2007	162,000	162	—	112,979	—	—	113,141
Common stock issued for put on equity line of credit on February 26, 2007	71,000	71	—	46,761	—	—	46,832
Common stock issued for put on equity line of credit on March 5, 2007	42,600	43	—	28,056	—	—	28,099
Common stock issued for put on equity line of credit on March 12, 2007	92,900	93	—	62,085	—	—	62,178
Common stock issued for put on equity line of credit on March 19, 2007	47,500	48	—	30,362	—	—	30,410
Common stock issued for put on equity line							

of credit on March 26, 2007	7,500	7	—	4,722	—	—	4,729
Common stock issued for put on equity line of credit on March 31, 2007	25,500	25	—	15,558	—	—	15,583
Fees paid on equity line of credit	—	—	—	(32,723)	—	—	(32,723)
Warrants issued with convertible notes	—	—	—	291,936	—	—	291,936
Intrinsic value of beneficial conversion associated with convertible notes	—	—	—	274,312	—	—	274,312
Fair value of warrants issued to non-employee for services	—	—	—	47,104	—	—	47,104
Fair value of options issued to officer	—	—	—	16,302	—	—	16,302
Net loss for three months ended March 31, 2007		—	—	—	—	(1,914,161)	(1,914,161)
Balance, March 31, 2007 (unaudited)	**40,687,707**	**40,688**	**60,000**	**30,436,189**	—	**(32,341,758)**	**(1,804,881)**

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

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
THREE MONTHS ENDED MARCH 31, 2007 AND 2006 AND FOR THE PERIOD FEBRUARY 18, 1998 (DATE OF INCEPTION) TO MARCH 31, 2007

	March 31, 2007	March 31, 2006	Cumulative since inception
Cash flows from operating activities			
Net loss	$(1,914,161)	$(2,998,105)	$(32,341,758)
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)
Stock based compensation expense	63,406	879,619	2,964,990
Issuance of common stock for services	—	—	4,668,102
Issuance of options for legal settlement	—	—	31,500
Issuance of warrants for legal settlement	—	—	4,957
Loss on valuation of warrants	13,102	—	13,102
Patent acquisition cost	—	—	1,610,066
Amortization of issuance costs and original issue debt	204,593	1,133,935	3,003,898
Amortization of deferred compensation	—	—	3,060,744
Depreciation	53,832	23,312	242,051
Changes in operating assets and liabilities:			
Inventory	(4,409)	—	(25,723)
Prepaid expenses and other	(12,911)	269	(94,143)
Other assets	—	—	(4,500)
Accounts payable and accrued expenses	276,023	25,007	2,508,137
Net cash used in operating activities	(1,320,525)	(935,963)	(14,870,785)
Cash flows from investing activities			
Purchase of property and equipment	(38,937)	(42,141)	(545,629)
Net cash used in investing activities	(38,937)	(42,141)	(545,629)
Cash flows from financing activities			
Net proceeds under equity line of credit	376,320	—	726,015
Increase in payables to related parties and shareholder	—	—	511,450
Advances from founding executive officer	—	—	517,208
Net proceeds from issuance of convertible notes and warrants	850,000	865,500	3,517,878
Repayment of convertible notes	(18,750)	—	(18,750)
Net proceeds from issuance of common stock and common stock issuable	—	153,127	10,254,949
Net cash provided by financing activities	1,207,570	1,018,627	15,508,750
Net increase (decrease) in cash	(151,892)	40,523	92,336
Cash, beginning of period	244,228	279,821	—
Cash, end of period	$ 92,336	$ 320,344	$ 92,336

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) — Continued
THREE MONTHS ENDED MARCH 31, 2007 AND 2006 AND FOR THE PERIOD FROM INCEPTION (FEBRUARY 18, 1998) TO MARCH 31, 2007

	March 31, 2007	March 31, 2006	Cumulative since inception
Supplemental disclosures of cash flow information			
Cash paid during the period for			
Interest	$ 3,079	$ —	$ 144,558
Income taxes	$ 800	$ 800	$ 4,282
Non-cash investing and financing activities			
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	—	—	113,981
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	—	—	2,580,086
Write off of deferred compensation	—	—	142,187
Consulting fee for issuance of stock options	16,302	—	16,302
Financing fee for issuance of warrants	47,104	—	47,104

See notes to condensed consolidated financial statements.

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

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
THREE MONTHS ENDED MARCH 31, 2007 (UNAUDITED)

1. Organization and basis of presentation

Basis of presentation

The accompanying interim condensed consolidated financial statements are unaudited, but in the opinion of management of Save the World Air, Inc. (the Company), contain all adjustments, which include normal recurring adjustments, necessary to present fairly the financial position at March 31, 2007, the results of operations and cash flows for the three months ended March 31, 2007 and 2006. The balance sheet as of December 31, 2006 is derived from the Company's audited financial statements.

Certain information and footnote disclosures normally included in financial statements that have been prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission, although management of the Company believes that the disclosures contained in these condensed consolidated financial statements are adequate to make the information presented therein not misleading. For further information, refer to the consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-KSB for the fiscal year ended December 31, 2006, as filed with the Securities and Exchange Commission.

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, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expense during the reporting period. Actual results could differ from those estimates. The consolidated results of operations for the three months ended March 31, 2007 are not necessarily indicative of the results of operations to be expected for the full fiscal year ending December 31, 2007.

Description of business

Save the World Air, Inc. (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. These technologies 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.

The Company was incorporated in Nevada on February 18, 1998 under the name Mandalay Capital Corp. The Company changed its name to Save the World Air, Inc. on February 11, 1999 following the purchase of the worldwide exclusive manufacturing, marketing and distribution rights for the ZEFS technology.

During the past several years, the Company has been acquiring new technologies, developing prototype products using the Company's technologies and conducting scientific

tests regarding the technologies and prototype products. The Company's 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, MK IV technologies. When fitted to an internal combustion engine, these products are expected to increase power and improve mileage and may also reduce carbon monoxide, hydrocarbons and nitrous oxide emissions and to. The Company also has developed certain products incorporating its CAT-MATE technology, although at this time the Company does not intend to devote significant effort to the commercialization of products incorporating the CAT-MATE technology.

The Company has obtained licenses 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 the Company's ZEFS and MK IV technologies, ELEKTRA incorporates a uniform electrical field principle. Based on the Company's early research and product development, the Company believes that ELEKTRA carries certain advantages over the Company's 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. When it is developed, the Company intends to market ELEKTRA products primarily to the transportation industry, oil refineries and pipelines, and OEMs.

The accompanying condensed consolidated financial statements of Save the World Air, Inc. and Subsidiary include the accounts of Save the World Air, Inc. and its wholly-owned subsidiary STWA Asia Pte. Limited, incorporated on January 17, 2006. As of March 31, 2007, the subsidiary held $8,478 in cash and had nominal operating expenses. Intercompany transactions and balances have been eliminated in consolidation.

2. 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 in the United States and certain countries in Asia; and the Company is in the early stages of developing ELEKTRA products. Expenses have been funded primarily 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.

3. Significant Accounting Policies

Revenue Recognition

The Company has adopted Staff Accounting Bulletin 104, "Revenue Recognition" and therefore recognizes revenue based upon meeting four criteria:

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

The Company contract manufactures fixed magnetic field products and sells them to various original equipment manufacturers in the motor vehicle and small utility motor markets. The Company negotiates 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, the Company recognizes the revenue associated with the sale of the products to the customer.

Inventories

Inventories are valued at the lower of cost (first-in, first-out) or market and consist of finished goods.

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.

Stock-based compensation

On January 1, 2006, the Company adopted Statements of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment," ("SFAS 123(R)") which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors based on estimated fair values. SFAS 123(R) supersedes the Company's previous accounting under Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25") for periods beginning in fiscal 2006.

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

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — Continued
THREE MONTHS ENDED MARCH 31, 2007 (UNAUDITED)

In March 2005, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 107 ("SAB 107") relating to SFAS 123(R). The Company has applied the provisions of SAB 107 in its adoption of SFAS 123(R).

The Company adopted SFAS 123(R) using the modified prospective transition method, which requires the application of the accounting standard as of January 1, 2006, the first day of the Company's fiscal year 2006. The Company's financial statements as of and for the three months ended March 31, 2007 reflect the impact of SFAS 123(R). In accordance with the modified prospective transition method, the Company's financial statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS 123(R). There was no stock-based compensation expense related to employee or director stock options recognized during the three months ended March 31, 2007. Stock-based compensation expense recognized under SFAS 123(R) for employee and directors for the three months ended March 31, 2007 was $16,302.

SFAS 123(R) requires companies to estimate the fair value of share-based payment awards to employees and directors on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in the Company's Statements of Operations. Stock-based compensation expense recognized in the Statements of Operations for the periods ended March 31, 2007 and 2006 included compensation expense for share-based payment awards granted prior to, but not yet vested as of January 1, 2006 based on the grant date fair value estimated in accordance with the pro-forma provisions of SFAS 123 and compensation expense for the share-based payment awards granted subsequent to January 1, 2006 based on the grant date fair value estimated in accordance with the provisions of SFAS 123(R).

For stock-based awards issued to employees and directors, stock-based compensation is attributed to expense using the straight-line single option method, which is consistent with how the prior-period pro formas were provided. As stock-based compensation expense recognized in the Statements of Operations for the periods ended March 31, 2007 and 2006 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

Prior to the adoption of SFAS 123(R), the Company accounted for stock-based awards to employees and directors using the intrinsic value method in accordance with APB 25. Under the intrinsic value method, the Company recognized share-based compensation equal to the award's intrinsic value at the time of grant over the requisite service periods using the straight-line method. Forfeitures were recognized as incurred.

The Company's determination of fair value of share-based payment awards to employees and directors on the date of grant using the Black-Scholes model, which is affected by the Company's stock price as well as assumptions regarding a number of highly complex and subjective variables. These variables include, but are not limited to our expected stock price volatility over the term of the awards, and actual and projected employee stock option exercise behaviors.

The Company has elected to adopt the detailed method provided in SFAS 123(R) for calculating the beginning balance of the additional paid-in capital pool ("APIC pool") related to the tax effects of employee stock-based compensation, and to determine the subsequent impact on the APIC pool and Statements of Cash Flows of the tax effects of employee stock-based compensation awards that are outstanding upon adoption of SFAS 123(R).

The Company accounts for stock option and warrant grants issued to non-employees for goods and services using the guidance of SFAS No. 123 and Emerging Issues Task Force ("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," whereby the fair value of such option and warrant grants is determined using the Black-Scholes option pricing model at the earlier of the date at which the non-employee's performance is completed or a performance commitment is reached.

4. Recent Accounting Pronouncements

Statement No. 157

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement No. 157, "Fair Value Measurements" ("SFAS 157"), SFAS 157 establishes a formal framework for measuring fair value under GAAP. It defines and codifies the many definitions of fair value included among various other authoritative literature, clarifies and, in some instances, expands on the guidance for implementing fair value measurements, and increases the level of disclosure required for fair value measurements. Although SFAS 157 applies to and amends the provisions of existing FASB and AICPA pronouncements, it does not, of itself, require any new fair value measurements, nor does it establish valuation standards. SFAS 157 applies to all other accounting pronouncements requiring or permitting fair value measurements, except for; SFAS 123R, share-based payment and related pronouncements, the practicability exceptions to fair value determinations allowed by various other authoritative pronouncements, and AICPA Statements of Position 97-2 and 98-9 that deal with software revenue recognition. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Management is currently evaluating the effect of this pronouncement on its financial statements.

Interpretation No. 48

Effective January 1, 2007, the Company adopted Financial Accounting Standards Board Interpretation No 48, "Accounting for Uncertainty in Income Taxes — an interpretation of FASB Statement No 109, "Accounting for Income Taxes ("FIN 48")." FIN 48 addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under FIN 48, the Company may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position should be measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. FIN 48 also provides guidance on de-recognition, classification, interest and penalties on income taxes, accounting in interim periods and requires increased disclosures. At the date of adoption, and as of March 31, 2007, the Company does not have a liability for unrecognized tax benefits.

The Company files income tax returns in the U.S. federal jurisdiction and the state of California. The Company is subject to U.S. federal or state income tax examinations by tax authorities for years after 2002. During the periods open to examination, the Company has net operating loss and tax credit carry forwards for U.S. federal and state tax purposes that have attributes from closed periods. Since these net operating losses and tax credit carry forwards may be utilized in future periods, they remain subject to examination. The Company's policy is to record interest and penalties on uncertain tax provisions as income tax expense. As of March 31, 2007, The Company has no accrued interest or penalties related to uncertain tax positions. The Company believes that it has not taken any uncertain tax positions that would impact its condensed consolidated financial statements as of March 31, 2007. Also as of the date of adoption, and as of March 31, 2007, the Company does not have a liability for unrecognized tax benefits.

EITF 00-19-2

Effective in the first quarter of 2007 the Company adopted FASB Staff Position No. EITF 00-19-2, "Accounting for Registration Payment Arrangements" issued on December 21, 2006 ("FSP 00-19-2"). FSP 00-19-2 specifies that the contingent obligation to make future payments or otherwise transfer consideration under a registration payment, whether issued as a separate agreement or included as a provision of a financial instrument or other agreement, should be separately recognized and measured in accordance with FASB Statement No. 5, "Accounting for Contingencies." For registration payment arrangements and financial instruments subject to those arrangements that were entered into prior to the issuance of EITF 00-19-2, this guidance is effective for financial statements issued for fiscal years beginning after December 15, 2006 and interim periods within those fiscal years.

5. Net loss per share

Basic earnings (loss) per share is computed by dividing net income (loss) available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted earnings 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 earnings of the Company. In computing diluted earnings 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 three months ended March 31, 2007 and 2006, the dilutive impact of outstanding stock options of 4,019,559 and 7,181,257 respectively, and outstanding warrants of 21,409,812 and 22,971,954 have been excluded because their impact on the loss per share is anti-dilutive.

6. Certain relationships and related transactions

Advances from founding executive officer

All of the marketing and manufacturing rights for the ZEFS were acquired from founding officer Jeffery A. Muller, for 5,000,000 shares of common stock, $500,000 and a $10 royalty for each unit sold (see discussion below), pursuant to the Agreement entered into in December 1998, by and between the Company and Mr. Muller. Working capital advances in the amount of $517,208 and payment in the amount of $500,000 for marketing and distribution rights of the ZEFS are due to Mr. Muller. Such amounts are interest free and do not have any due dates for payment.

In January 2000, the Company entered into an agreement offering Mr. Muller and Lynne Muller, Mr. Muller's wife, the option to purchase 5,000,000 shares each at $0.10 per share as consideration for work performed for the Company. Mrs. Muller subsequently transferred her option to Mr. Muller.

In connection with the Company's legal proceedings against Mr. Muller (see Note 11), the Company has canceled (i) the 8,047,403 shares of its common stock held by Mr. Muller and/or his affiliates, (ii) the options to acquire an additional 10,000,000 shares of the Company's common stock held by Mr. Muller personally and (iii) the $1,017,208 of debt which Mr. Muller claimed was owed to him by the Company.

Loans from related parties

Interest expense recognized under related-party loans was immaterial for all periods presented. Interest expense recognized under related-party loans for the period from February 18, 1998 (date of inception) through March 31, 2007 was $327.

Lease agreement

During 2003, the Company entered into a sublease agreement with an entity to lease office space in North Hollywood, California for its principal executive offices. Bruce H. McKinnon, the former President and Chief Executive Officer and an incumbent director of the Company, is an owner of the sublessor.

In August 2005, the Company amended this sublease agreement. The original lease term was from November 1, 2003 through October 16, 2005 and carried an option to renew for two additional years with a 10 percent increase in the rental rate. Monthly rent under this lease is $3,740 per month under this lease. The Company exercised its option to renew the lease through October 15, 2007.

In January 2006, the Company further amended this sublease agreement, as a result of taking more space and obtaining expanded support services. The term of the sublease was amended to July 31, 2007 and carries an option to renew for two additional years with a 10 percent increase in the rental rate. Monthly rent is $6,208 per month under this amended sublease agreement. Additionally, the Company began leasing two additional office spaces for $964 per month beginning July 2006 on a month-to-month basis.

During the three months ended March 31, 2007 and 2006, rent expense under the sublease was $67,015 and $18,624, respectively. The amount for the three months ended March 31, 2007 includes $45,500 with respect to a late penalty of $100 per day since January 1, 2006. The Company does not admit that it owes this amount.

Marketing and promotional services agreement

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. SS Sales will also provide advice, assistance and information on marketing the Company’s products in the automotive after-market, and will seek to recruit and establish a market with distributors, wholesalers and others. SS Sales will be paid a commission equal to 5% of the gross amount actually collected on contracts the Company entered into during the contract term for existing or future customers introduced by SS Sales in the Territory. The contact 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. No amount was due or paid under this contract as of March 31, 2007. SS Sales is owned by Nathan Shelton, who has served as one of the directors of the Company since February 12, 2007.

7. Equity line of credit

In September 2006, the Company entered into what is sometimes termed an equity line of credit arrangement. Under the line of credit the Company may, but is not obligated to, put shares of common stock from time to time over a 36-month period, at a purchase price calculated at 97% of the lowest best closing bid for the Company's common stock for the five trading days following the put notice. The Company may draw up to $10,000,000 under the line of credit. Because the price of the common stock fluctuates and the number of shares of common stock, if any, that the Company may issue, should exercise the put rights under the equity line of credit, will vary, the Company does not know how many shares, if any, will actually issue under the equity line of credit. As of March 31, 2007 the Company has registered and made available 7,000,000 shares of common stock for possible future draws under the line of credit.

As of March 31, 2007 the Company has drawn down $739,138 ($676,013 net of closing costs) of this commitment and issued 1,093,494 shares of common stock, leaving 5,906,506 shares of common stock still available under the equity line of credit.

8. Convertible debentures

During the year ended December 31, 2005, the Company completed the first part of a private offering of its 9% Convertible Notes due at dates ranging between May 31, 2006 and July 31, 2006 (the "Notes") and Warrants to purchase shares of the Company's common stock which expire between August 31, 2007 and December 28, 2007 (the "Warrants"). The Notes are convertible at $0.70 per share of common stock and the Warrants entitle the holder to purchase a number of shares of the Company's common stock equal to 150% of the number of shares of common stock into which the Note is convertible. The Warrants are exercisable at a price of $1.00 per share.

During the year ended December 31, 2005, the Company issued Notes totaling $1,576,378 and paid related transaction fees of $123,196, resulting in net proceeds to the Company of $1,453,182. In addition to the cash paid for transaction fees, 166,126 additional Warrants were issued to certain placement agents. These Warrants expire between August 31, 2007 and December 28, 2007 and are exercisable at a price of $1.00 per share.

The aggregate value of the Warrants issued in connection with the offering and to the finder were valued at $696,413 using the Black-Scholes option valuation model with the following assumptions; risk-free interest rate of 4.02% to 4.45%; dividend yield of 0%; volatility factors of the expected market price of common stock of 83.59%; and an expected life of two years (statutory term). The company also determined that the notes contained a beneficial conversion feature of $756,768.

The value of the Warrants of $696,413, the conversion option of $756,768, and the transaction fees of $123,196 are considered as debt discount and are being amortized over

the life of the Notes. During 2005, $318,759 of such discount has been amortized and included in the accompanying statements of operations. The remaining unamortized debit discount as of December 31, 2005 of $1,257,619 has been netted against the convertible debentures.

During the year ended December 31, 2006, the Company issued additional Notes totaling $1,000,000 which included the conversion of $45,000 of debt owed to the Company's Chief Financial Officer. The Company paid related transaction fees of $89,500 resulting in net proceeds to the Company of $865,500. In addition to the cash paid for transaction fees, 117,857 additional Warrants were issued to certain placement agents. These Warrants expire between August 31, 2007 and February 9, 2008 and are exercisable at a price of $1.00 per share.

The aggregate value of the Warrants issued in connection with the offering and to the placement agent were valued at $620,252 using the Black-Scholes option valuation model with the following assumptions; risk-free interest rate of 4.35% to 4.66%; dividend yield of 0%; volatility factors of the expected market price of common stock of 130.61%; and an expected life of two years (statutory term). The company also determined that the notes contained a beneficial conversion feature of $290,248.

The value of the Warrants of $620,252, the conversion option of $290,248, and the transaction fees of $89,500 are considered as debt discount and are being amortized over the life of the Notes.

During the year ended December 31, 2006, convertible notes in the amount of $2,576,379 of the Notes were converted to 3,680,540 shares of stock at $0.70 per share. In addition, $3,707 of accrued interest was converted to 5,296 shares at $0.70 per share. For the year ended December 31, 2006, $2,257,620 of the total discount has been amortized and included in the accompanying consolidated statement of operations.

On December 5, 2006, the Company entered into a Note Purchase Agreement (the "Agreement") with Morale Orchards, LLC, a limited liability company formed under the laws of the State of Oregon ("Morale"). The entire equity interest in Morale is beneficially owned by Leodis Matthews who provides legal services to the Company. The 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 the Company's common stock (the "Common Stock"). The aggregate purchase price for the Notes and Warrants is $1,000,000. Therefore, while the stated interest on the Notes is 0%, the effective interest rate is 22.5% because the Notes are being purchased at a discount from their face amount.

Each of the Morale Notes is convertible into shares of the Company's Common Stock at a per share conversion price initially equal to the closing price of a share of the Company's Common Stock on the trading day prior to the date of issuance of such Note. The conversion right is exercisable during the period commencing 90 days prior to the maturity of each Note. Concurrently with the issuance of a Note, for no additional consideration,

Morale will acquire Warrants to purchase a number of shares of Common Stock equal to 50% of the number of shares of Common Stock initially issuable on conversion of the associated Note. The Morale Warrants become exercisable 180 days after the date of their issuance. The Note purchased by Morale on December 5, 2006 is convertible at the rate of $0.85 per share into 720,588 shares of the Company's Common Stock and the Morale Warrants are exercisable at the same per share price for 360,294 shares of the Company's Common Stock.

Repayment of each Note is to be made monthly, at an amount equal to at least $3,750 for each Note. Additional payments may be made prior to maturity with no prepayment penalties. In the event the Company has not repaid each Note in full by the anniversary date of its issuance, the remaining balance shall be increased by 10% as an initial penalty, and the Company shall pay additional interest of 2.5% per month, compounded daily, for each month until such Note is paid in full.

Morale has piggyback registration rights pursuant to which Morale may require the Company to include the shares of the Company's Common Stock issuable upon conversion of the Morale Notes and exercise of the Morale Warrants in certain future registration statements the Company may elect to file, subject to the right of the Company and/or its underwriters to reduce the number of shares to be included in such a registration in good faith based on market or other conditions.

During the year ended December 31, 2006, the Company issued Morale Notes totaling $612,500 discounted by $112,500, resulting in net proceeds to the Company of $500,000. In addition to the discount, 360,264 additional warrants were issued to Morale. These warrants expire December 5, 2011 and are exercisable at a price of $0.85 per share.

The aggregate value of the Morale Warrants issued in connection with the offering and to the finder were valued at $118,348 using the Black-Scholes option valuation model with the following assumptions; risk-free interest rate of 4.39%; dividend yield of 0%; volatility factors of the expected market price of common stock of 110.21%; and an expected life of five years (statutory term) and vest over 180 days. The Company also determined that the notes contained a beneficial conversion feature of $230,848.

The value of the Morale Warrants of $118,348, the conversion option of $230,848, and the transaction fees of $112,500 are considered as debt discount and are being amortized over the life of the Note.

During the three months ended March 31, 2007, the Company issued Morale Notes totaling $612,500 discounted by $112,500, resulting in net proceeds to the Company of $500,000. In addition to the discount, 437,500 warrants were issued to Morale. These warrants expire January 10, 2011 and are exercisable at $0.70 per share. The note is convertible at the rate of $0.70 per share into 875,000 shares of the Company's Common Stock.

The aggregate value of the Morale Warrants issued in connection with the offering were valued at $118,955 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 245%; and an expected life of five years (statutory term) and vest over 180 days. The Company also determined that the notes contained a beneficial conversion feature of $231,455.

The value of the Morale Warrants of $109,826, the conversion option of $222,326 and the transaction fees of $112,500 are considered as debt discount and being amortized over the life of the note.

During the three months ended March 31, 2007, the Company conducted an offering (the “2007 PIPE Offering”), through Spencer Clarke LLC, as exclusive placement agent, of up to $2,000,000 principal amount of its 10% convertible notes (the “2007 PIPE Notes”). Interest on the 2007 PIPE Notes, at a rate of 10% per annum, is payable quarterly. The Notes are due nine months from date of issuance. The Notes are convertible into shares of Common Stock at an initial conversion price of $0.70 per share (the “Conversion Shares”).

The Company has the right to redeem any or all of the outstanding 2007 PIPE Notes in its sole discretion anytime after the termination of the 2007 PIPE Offering and prior to the maturity date of the 2007 PIPE Notes. The redemption price shall be the face amount of the redeemed Notes plus accrued and unpaid interest thereon. Subject to the following sentence, at any time prior to the maturity date of the 2007 PIPE Notes, for each additional $1,000,000 of gross proceeds raised from one or more offerings of the Company’s equity or quasi-equity securities, the Company shall redeem 2007 PIPE Notes with a minimum face value of $500,000 together with accrued and unpaid interest, until the entire outstanding 2007 PIPE Note is redeemed. Certain financings that the Company may conduct outside of North America are exempt from this provision to redeem the 2007 PIPE Notes in whole or in part.

Investors in the 2007 PIPE Offering received, for no additional consideration, a warrant (the “2007 PIPE Warrant”), entitling the holder to purchase a number of shares of the Company’s common stock equal to 150% of the number of shares of common stock into which the 2007 PIPE Notes are convertible (the “Warrant Shares”). The 2007 PIPE Warrant will be exercisable on a cash basis only and will have registration rights. The 2007 PIPE Warrant is exercisable at an initial price of $1.00 per share, and is exercisable immediately upon issuance and for a period of three years from the date of issuance.

Promptly, but no later than 90 days following the closing date of the 2007 PIPE Offering, the Company is required to file a registration statement with the SEC to register the Conversion Shares and the Warrant Shares. The Company shall use its best efforts to ensure that such registration statement is declared effective within 120 days after filing.

During the three months ended March 31, 2007, the Company issued $350,000 of the PIPE Notes and 750,001 warrants. The Company had related transaction fees of $42,000 resulting in net proceeds to the Company of $308,000. In addition to the transaction fees, 75,000 Warrants were issued to certain placement agents. These Warrants expire March 1, 2010 and are exercisable at a price of $1.00 per share.

The aggregate value of the Warrants issued in connection with the offerings and to the finder were valued at $214,179 using the Black-Scholes option valuation model with the following assumptions; risk-free interest rate of 4.40% to 5.16%; dividend yield of 0%; volatility factors of the expected market price of common stock of 100.28% to 114.98%; and an expected life of two years (statutory term). The company also determined that the notes contained a beneficial conversion feature of $42,857.

The value of the Warrants of $283,807, the conversion option of $265,183 and the transaction fees of $112,500 are considered as debt discount and are being amortized over the life of the Notes.

For the three months ended March 31, 2007 and 2006, $204,593 and $1,133,936 of all the total discounts has been amortized and included in the accompanying statement of operations.

During the three months ended March 31, 2007 and 2006, no Notes were converted to shares of stock.

9. Capital stock

As of March 31, 2007, the Company has authorized 200,000,000 shares of its common stock, of which 40,687,707 shares were issued and outstanding.

During the year ended December 31, 2005, the Company issued 1,599,500 shares of common stock and 1,599,500 warrants, each warrant to acquire a share of common stock at an exercise price of $1.50 per share, for net proceeds of $1,490,660. The 1,599,500 warrants were issued to investors as part of an equity agreement and were not ascribed any value in the accompanying financial statements. Of the 1,599,500 shares of common stock issued, the Company issued 69,000 shares of common stock for which payment was previously received. The Company also issued 50,500 shares of common stock for the exercise of warrants, 50,000 of which payment was previously received.

The warrants issued above were part of a private offering of 2,872,000 shares of common stock and warrants that began July 29, 2004 and concluded on July 22, 2005. The expiration date of each of the warrants was previously extended by one hundred eighty (180) days from its original expiration date. On February 6, 2006, the Company extended the expiration date for each of the warrants by an additional one hundred eighty-five (185) days, for a total extension of one year from its original expiration date.

During the year ended December 31, 2005, the Company agreed to issue 846,548 shares of common stock in settlement of accrued expenses of $612,521. These shares were reflected as common stock to be issued in the accompanying December 31, 2005 financial statements, and were subsequently issued in 2006.

In late 2005 and early 2006, the Company conducted an offering (the "Bridge Offering") and sold an aggregate $1,075,000 principal amount of its 9% convertible subordinated notes (the "Bridge Notes") and issued warrants ("Bridge Warrants") to purchase up to 2,303,568 shares of the Company's common stock at $1.00 per share, to certain investors. Net proceeds to the Company from the sale of the Bridge Notes were $935,250. All of the Bridge Notes were converted voluntarily by the holders of the Bridge Notes into 1,535,715 shares of the Company's common stock (the "Bridge Shares"), at a conversion price of $0.70 per share, on or prior to the maturity date of the Bridge Notes on May 31, 2006.

In April 2006, the Company conducted an offering (the "Overseas Offering") and sold 473,000 shares of the Company's common stock at $1.56 per share and issued warrants to purchase up to 118,250 shares of our common stock at an exercise price of $2.60 per share, to two overseas investors. The Company raised $737,881 gross proceeds ($667,803 net proceeds) in this offering.

In May 2006, the Company conducted an offering (the "PIPE Offering") and sold 873,018 shares of the Company's common stock (the "PIPE Shares") at $1.89 per share and issued warrants (the "PIPE Warrants") to purchase up to 436,511 shares of the Company's common stock at $2.70 per share, through the Company's exclusive placement agent, Spencer Clarke LLC ("Spencer Clarke"). The Company raised $1,650,009 gross proceeds ($1,435,508 net proceeds) in the PIPE Offering.

On June 28, 2006, the Company filed a registration statement to register the Bridge Shares and the PIPE Shares, and the shares of the Company's common stock issuable upon exercise of the Bridge Warrants, the PIPE Warrants and warrants issued to Spencer Clarke for various investment banking and other related services, including services in connection with the Bridge Offering, the Overseas Offering and the PIPE Offering. The registration statement was declared effective by the SEC on July 24, 2006.

During the year ended December 31, 2006, convertible notes in the amount of $2,576,379 of the Company's previously issued and outstanding Investor Notes were converted to 3,680,540 shares of common stock, at a conversion rate of $0.70 per share. In addition, $3,707 of accrued interest was converted to 5,296 shares of common stock, at a conversion rate of $0.70 per share. The Company did not receive any proceeds in connection with the conversion of the Investor Notes.

During the year ended December 31, 2006, individuals exercised outstanding warrants to purchase 2,328,452 shares of common stock for gross and net proceeds of $1,623,327.

10. Stock options and warrants

The Company currently issues stock options to employees, directors and consultants under the 2004 Stock Plan (the "Plan"). As of December 31, 2005, 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, increasing the authorized

shares by 2,000,000 shares to 7,000,000 shares. At March 31, 2007, 2,980,441 shares of common stock were available to be granted under the Plan. Prior to 2004, the Company granted to officers of the Company outside the Plan options to purchase 3,250,000 shares of common stock, which options 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 March 31, 2007 and December 31, 2006 was 7.56 years and 5.53 years, respectively. Stock option activity for the three months ended March 31, 2007 and the year ended December 31, 2006 was as follows, which includes 3,250,000 options granted outside the Plan:

	Weighted Avg. Options	Weighted Avg. Exercise Price
Options, January 1, 2004	13,250,000	0.11
Options granted	1,172,652	1.03
Options exercised	—	—
Options cancelled	—	—
Options, December 31, 2004	14,422,652	0.18
Options granted	2,085,909	0.92
Options exercised	—	—
Options cancelled	(10,000,000)	0.10
Options, December 31, 2005	6,508,561	0.53
Options granted	1,313,605	1.21
Options exercised	(2,860,000)	0.10
Options forfeited	(962,607)	0.84
Options cancelled	—	—
Options, December 31, 2006	3,999,559	0.99
Options granted (unaudited)	20,000	0.85
Options exercised (unaudited)	—	—
Options forfeited (unaudited)	—	—
Options cancelled (unaudited)	—	—
Options, March 31, 2007 (unaudited)	4,019,559	$ 0.99

During the three months ended March 31, 2007, the Company granted an option for 20,000 shares to an officer. The options were valued at $16,302 using the Black-Scholes pricing model.

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

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — Continued
THREE MONTHS ENDED MARCH 31, 2007 (UNAUDITED)

Options outstanding at March 31, 2007 and the related weighted average exercise price and remaining life information is as follows: (Unaudited)

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

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — Continued
THREE MONTHS ENDED MARCH 31, 2007 (UNAUDITED)

Exercise prices	Total options outstanding	Weighted average remaining life in years	Total weighted average exercise price	Options exercisable	Exercisable weighted Average exercise price
0.40	250,000	4.55	0.40	250,000	0.40
0.85	2,095,000	8.58	0.85	2,095,000	0.85
0.98	650,000	6.16	0.98	650,000	0.98
1.00	370,000	8.23	1.00	370,000	1.00
1.15	193,912	6.93	1.15	193,912	1.15
1.69	310,647	8.90	1.69	310,647	1.69
2.26	150,000	3.56	2.26	30,000	2.26
$0.40-$2.26	4,019,559	7.56	$ 0.99	3,899,559	$ 0.95

Intrinsic value of employee options

During 2004 and prior, certain employee options were granted with exercise prices less the than fair market value of the Company's stock at the date of grant. As the grants were to employees, the intrinsic value method, as allowed under APB No. 25, was used to calculate the related compensation expense. For the year ended December 31, 2004, the Company granted 1,172,652 options to certain employees, exercisable at amounts ranging from $0.98 to $1.27, vested over one year with a ten-year life, except for 78,740 options issued to an employee who is a 10 percent beneficial owner of the Company. The life of these options is 5 years. Options granted in 2004 were valued using the intrinsic method at $248,891.

During the year ended December 31, 2005, certain employee options were granted with exercise prices less the than fair market value of the Company's stock at the date of grant. As the grants were to employees, the intrinsic value method was used to calculate the related compensation expense. For the year ended December 31, 2005, the Company granted 2,085,909 options to certain employees, exercisable at amounts ranging from $0.85 to $1.10, vested over one year with a ten-year life, except for 90,909 options issued to an employee who is a 10 percent beneficial owner of the Company. The life of these options is 5 years. Options granted in 2005 were valued using the intrinsic method at $243,750.

Black-Scholes value of employee options

During the three months ended March 31, 2007, the Company valued employee options at the grant date using the Black-Scholes pricing model with the following average assumptions:

Expected life (years)	5.26
Risk free interest rate	4.02%
Volatility	188.83%
Expected dividend yield	0.00%

The weighted average fair value for options granted in 2005 was $0.69.

Warrants

The following table summarizes certain information about the Company's stock purchase warrants.

	Warrants	Weighted Avg. Exercise Price
Warrants outstanding, January 1, 2004	14,252,414	$ 0.48
Warrants granted	2,372,500	1.27
Warrants exercised	(960,500)	0.20
Warrants cancelled	—	—
Warrants outstanding, December 31, 2004	15,664,414	0.62
Warrants granted	5,198,574	1.16
Warrants exercised	(50,500)	0.99
Warrants cancelled	(20,000)	1.50
Warrants outstanding, December 31, 2005	20,792,488	0.75
Warrants granted	3,624,894	1.28
Warrants exercised	(2,328,452)	0.68
Warrants cancelled	(1,191,619)	1.46
Warrants outstanding, December 31, 2006	20,897,311	0.81
Warrants granted (unaudited)	1,262,501	0.90
Warrants exercised (unaudited)		
Warrants cancelled (unaudited)	(750,000)	1.50
Warrants outstanding, March 31, 2007 (unaudited)	21,409,812	0.78

During February 2006, the Company issued 250,000 performance based warrants to an outside consultant. These warrants are to be exercisable at $.40 per share, are fully vested and exercisable immediately. These warrants were valued at $401,130 using the Black-Scholes option valuation model with the following assumptions: risk-free interest rate of 4.59%, dividends yield of 0%, volatility factors of the expected market price common of 130.61%, and an expected life of five years.

In April 2006, the Company entered into a one-year agreement with an outside consultant to provide public relations services. The terms of the agreement calls for monthly payments of $7,000. Additionally, the Company issued a five-year warrant to the consultant. The warrant is exercisable for up to 100,000 shares of common stock at an exercise price of $2.30 per share and vests as to 8,333 shares per month commencing April 30, 2006. The shares issuable upon exercise of the warrant have piggyback registration rights. In August 2006 the Company terminated the agreement. The consultant earned 41,665 warrants and the remaining balance of 58,335 were forfeited.

During the three months ended March 31, 2007, the Company did not issue any warrants for services other than what is stated in Note 7.

11. Research and development

The Company has research and development facilities in Morgan Hill, California and Queensland, Australia. The Company has expanded research and development to include application of the ZEFS, MK IV and CAT-MATE technologies for diesel engines, motorbikes, boats, generators, lawnmowers and other small engines. The Company has purchased test vehicles, test engines and testing equipment. The Company has completed testing on products incorporating its ZEFS, MK IV and CAT-MATE technologies for multiple automobiles, trucks motorcycles, off-road vehicles and stationary engines, the results of which have been provided to RAND Corporation (RAND) for evaluation. RAND oversees the research and development facilities. The Company also uses third party research and development facilities in Los Angeles, California for the development of the ZEFS and CAT-MATE devices. The Company spent $340,452 and $57,294 for the three months ended March 31, 2007 and 2006, respectively.

12. Going concern

The accompanying condensed consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of liabilities and commitments in the normal course of business. As reflected in the accompanying condensed consolidate financial statements, the Company had a net loss of $1,914,161 and a negative cash flow from operations of $1,320,525 for the three months ended March 31, 2007, and had a working capital deficiency of $2,116,509 and a stockholders' deficiency of $1,804,881 at March 31, 2007. These factors raise substantial doubt about the Company's ability to continue as a going concern. The ability of the Company to continue as a going concern is dependent upon the Company's ability to raise additional funds and implement its business plan. The condensed consolidated financial statements do not include any adjustments that might be necessary if the Company is unable to continue as a going concern.

13. 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 us, 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 our 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 corporation, 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. The SEC's charges of fraud and stock manipulation continue against Mr. Muller and others.

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 our 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 own or control, 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 prevents Mr. Muller from engaging in any effort to exercise control over the Company's corporation and from serving as an officer or director of the Company. While the Company believes that the Company has valid claims, there can be no assurance that an adverse result or settlement would not have a material adverse effect on the Company's financial position or cash flow..

In the course of the litigation, the Company has obtained ownership control over Mr. Muller's claimed patent rights to the ZEFS device. Under a Buy-Sell Agreement between Mr. Muller and the Company dated December 29, 1998, Mr. Muller, who was listed on the ZEFS devise patent application as the inventor of the ZEFS device, purported to grant us all international marketing, manufacturing and distribution rights to the ZEFS device. Those

rights were disputed because an original inventor of the ZEFS device contested Mr. Muller's legal ability to have conveyed those rights.

In Australia, Mr. Muller entered into a bankruptcy action seeking to overcome the Company's claims for ownership of the ZEFS device. In conjunction with these litigation proceedings, a settlement agreement was reached whereby the $10 per unit royalty previously due to Mr. Muller under his contested Buy-Sell Agreement was terminated and replaced with a $.20 per unit royalty payable to the bankruptcy trustee. On November 7, 2002, under a settlement agreement executed with the Mr. Muller's bankruptcy trustee, the trustee transferred to the Company all ownership and legal rights to this international patent application for the ZEFS device.

Both the SEC and the Company have filed Motions for Summary Judgment contending that there are no material issues of fact in contention and as a matter of law, the Court should grant a judgment against Mr. Muller and the cross-defendants.

Mr. Muller and several of the defendants filed a Motion to Dismiss the complaint filed by the Company and moved for summary judgment in their favor. On December 28, 2004, Judge George B. Daniels denied the cross-defendants' motion to dismiss the Company's cross-complaint, denied the request to vacate the July 2, 2002 preliminary injunction and denied the request for damages against the Company. The court also refused to grant a summary judgment in favor of the cross-defendants and dismissed Mr. Muller's claims against the Company for indemnification for his legal costs and for damages resulting from the litigation. Neither Mr. Muller nor any of the cross-defendants have filed any cross-claims against the Company and the Company is not exposed to any liability as a result of the litigation, except for possibly incurring legal fees and expenses should the Company lose the litigation.

On November 16, 2005, the Court granted the SEC's motion for summary judgment. In granting the motion, the Court has 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 our stock that he still owns and directed the Company to cancel any issued and outstanding shares of our stock still owned by Mr. Muller. Mr. Muller was also ordered to disgorge to the SEC unlawful profits in the amount of $7.5 million and a pay a civil penalty in the amount of $100,000. Acting in accordance with the Court's order, the Company has canceled (i) 8,047,403 shares of its common stock 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.

Mr. Muller subsequently filed a Notice of Appeal from the Judgment resulting from this decision to the Second Circuit Court of Appeals in New York. The clerk of the Court recently issued an Order dismissing this appeal.

In response to the November 16, 2005 decision by the Court, Muller filed a motion seeking to set aside the decision and order of the Court. On March 31, 2006, the Court issued a

decision and order denying Muller's motion to set aside the decision on summary judgment issued against Muller on November 16, 2005.

On October 27, 2006, Magistrate Judge Frank Maas, Federal District Court of the Southern District of New York, issued an order granting summary judgment in favor of the Company. The ruling provided that all shares, options and any other obligations allegedly owed by the Company to Jeffrey A. Muller, its former Chairman, were to be disgorged. The ruling also confirmed an earlier decision issued on November 16, 2005 in favor of the SEC holding Mr. Muller liable for $7.5 million in actual damages, imposing a $100,000 fine and barring 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 $9 million. Additionally, the Court further clarified that the scope of its previous disgorgement order required the disgorgement of any shares of the Company's stock that Mr. Muller or any of his nominees directly or indirectly own or control. The Company has taken action to cancel over 3.6 million shares which had been issued to the offshore companies.

The Court also confirmed the appropriateness of an action 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.

Finally, the Court ruled that Mr. Muller had no claim to an alleged $500,000 debt owed to him while the damages of over $9 million remain unpaid. The Court also ruled that other assets that were transferred by Mr. Muller to members of his family through various offshore corporations were also to be disgorged. Because the Court left unresolved an issue concerning claims against one Muller family member, the Company sought a modification of the Order. On February 8, 2007, Judge Maas issued an Amended Order which concluded that all of the STWA shares of Muller or any of his nominees directly or indirectly owned or controlled were to be recaptured by STWA and were subject to disgorgement and forfeiture. With this modification of the October 27, 2007 ruling, this order provides the complete relief requested by the Company in its motion for summary judgment.

In April 2005, Jeffrey A. Muller, the Company's former sole director and executive officer, filed a lawsuit in the Federal District Court for the Central District of California, seeking declaratory and injunctive relief and alleging unfair competition in connection with a claimed prior patent interest in the ZEFS device and stock option rights. In seeking declaratory relief, Mr. Muller is seeking to have the patent rights in the ZEFS device that were previously transferred to the Company by Mr. Muller's bankruptcy trustee declared null and void.

This lawsuit brought by Mr. Muller arises out of the same claims that are the subject of ongoing litigation in the Federal District Court for the Southern District of New York, in which the Company has previously obtained a preliminary injunction against Mr. Muller barring him from any involvement with the Company and preventing Mr. Muller, his agents or assigns, from exercising any claimed rights to the Company's assets or stock. Mr. Muller

previously filed the same complaint in the Federal District Court for the Southern District of New York, which claim is pending dismissal. On December 28, 2004, Federal District Court Judge George B. Daniels issued a decision dismissing motions filed by Mr. Muller against the Company's cross-claims. The dismissal of those motions involved similar causes of action as those contained in Mr. Muller's recent lawsuit commenced in the Federal District Court for the Central District of California. Since the case in New York is still pending, the filing of the new lawsuit in California is subject to various defenses which should result in the dismissal of the new lawsuit.

On January 25, 2006, Mr. Muller's complaint, filed in the California District Court and transferred to the Federal Court in the Southern District of New York, was assigned to Judge George B. Daniels. That Complaint is currently pending, however, the issues raised in this Complaint arise from the same claims already decided by the Court in its February 8, 2007 Amended Order. The Company plans to file a request to dismiss the pending Complaint on several grounds, including that the claims sought to be litigated in this latter complaint has been included within the Summary Judgment Motions decided against Muller, his nominees and assignees. While the Company believes that the Company has valid claims and defenses, there can be no assurance that an adverse result or outcome on the pending motions or a trial of this case would not have a material adverse effect on our financial position or cash flow.

On July 19, 2007, Scottish Glen Golf Company, Inc. doing business as KZG ("KZG") sued the Company in Los Angeles Superior Court, alleging unlawful detainer by the Company of its leased corporate offices at 5125 Lankershim Boulevard, North Hollywood, California, and failure to pay past due rent and penalties in the aggregate amount of $104,413.20. In its complaint, KZG also seeks attorney fees. The Company does not admit that it owes the entire amount claimed by KZG.

Employment agreements

In July 2005, the Company entered into an employment agreement with an individual to serve as a Vice President of Operations for the Company. The agreement expired December 31, 2005, with an automatic one-year extension and provided for annual base salary of not less than $120,000 per year. Effective February 21, 2006, the individual was promoted to Executive Vice President, his annual base salary was increased from $120,000 per year to $150,000 per year and the term of his employment agreement was extended to December 31, 2007. Effective August 8, 2006, the individual was promoted to Chief Operating Officer and his annual base salary was increased from $150,000 per year to $200,000 per year. During the employment term, the individual is eligible to participate in certain incentive plans, stock option plans and similar arrangements in accordance with the Company's recommendations at award levels consistent and commensurate with the position and duties hereunder.

On November 9, 2006, the individual who served as the Company's Chief Executive Officer and Chief Financial Officer resigned, due to a medical disability. His resignation as Chief Executive Officer took effect on November 20, 2006 and his resignation as Chief Financial Officer takes effect on the earlier to occur of (i) the appointment of his successor or (ii) January 31, 2007. He will continue to serve as a director of the Company.

Under the terms of the separation agreement as an officer of the Company, he is entitled to be paid out the remainder of the cash portion of his employment agreement through December 31, 2007, in accordance with the Company's normal pay policies. Options granted to him in February 2006 have been accelerated, vested on November 20, 2006

and were recalculated under 123R; additionally, the former officer will have until November 20, 2007 to exercise such options. He is also entitled to receive a stock option grant in 2007 equal to the lesser of (i) the number of stock options he was granted in 2006 or (ii) the highest number of options granted to any of the then Chief Executive Officer, President or Chief Financial Officer on an annualized basis, on terms no less favorable as granted to such person; provided, however, that such options to be granted to the former officer shall be fully vested upon grant and shall be exercisable for one year from the date of grant. The Company and the former officer have waived any claims they may have against each other and have agreed to mutual indemnification. The Company expensed $345,000 for the remaining term of his employment agreement and benefits for the year ended December 31, 2006.

Including those agreements entered into prior to 2006, minimum guaranteed compensation payments under employment agreements, as amended, by year are as follows:

As of December 31:

Year	
2007	$741,000
2008	$ 10,000
Total	$751,000

During the quarter ended March 31, 2007, approximately $127,000 was paid for employment agreement.

Consulting agreements

In April 2006, the Company entered into a one-year agreement with an outside consultant to provide public relations services. The terms of the agreement calls for monthly payments of $7,000. Additionally, the Company issued a five-year warrant to the consultant. The warrant is exercisable for up to 100,000 shares of common stock at an exercise price of $2.30 per share and vests as to 8,333 shares per month commencing April 30, 2006. The shares issuable upon exercise of the warrant have piggyback registration rights. In August 2006 the Company terminated the agreement. The consultant earned 41,665 warrants and the remaining balance of 58,335 were forfeited.

Leases

During 2003, the Company entered into a sublease agreement with an entity to lease office space in North Hollywood, California for its principal executive offices. Bruce H. McKinnon, the former President and Chief Executive Officer and an incumbent director of the Company, is an owner of the sublessor.

In August 2005, the Company amended this sublease agreement. The original lease term was from November 1, 2003 through October 16, 2005 and carried an option to renew for two additional years with a 10 percent increase in the rental rate. Monthly rent under this

lease is $3,740 per month under this lease. The Company exercised its option to renew the lease through October 15, 2007.

In January 2006, the Company further amended this sublease agreement, as a result of taking more space and obtaining expanded support services. The term of the sublease was amended to July 31, 2007 and carries an option to renew for two additional years with a 10 percent increase in the rental rate. Monthly rent is $6,208 per month under this amended sublease agreement. Additionally, the Company began leasing two additional office spaces for $964 per month beginning July 2006 on a month-to-month basis.

In November 2003, the Company entered into a lease for a research and development facility located in Queensland, Australia. The term of the lease is from November 15, 2003 through March 15, 2006 and carries an option to renew for two additional years each with an increase of the greater of 5% or the increase in the then current Australian Consumer Price Index. Monthly rent is AUD $1,292 (approximately US $1,000) per month under this lease. In March 2006, the Company entered into a new lease for this facility for a term of two years commencing March 15, 2006. Monthly rent is AUD $1,462 (approximately US $1,100) per month.

In September 2005, the Company entered into a lease for a testing facility located in Morgan Hill, California. The term of the lease is from September 1, 2005 through August 31, 2007 and carries an option to renew for two additional years at the then prevailing market rate. Monthly rent is $2,240 per month under this lease. The lease was amended in February 2006 for additional space. Monthly rate under the amended lease is $4,160 per month. The Company currently intends to renew this lease prior to the end of the term on August 31, 2007.

Total rent expense under these leases for the three-month periods ended March 31, 2007 and 2006, is $83,798 and $33,769, respectively. The amount for the three months ended March 31, 2007 includes $45,500 with respect to a late penalty of $100 per day since January 1, 2006. The Company does not admit that it owes this amount.

The following is a schedule by years of future minimum rental payments required under the non-cancelable operating leases as of March 31, 2007.

Years Ending December 31,	
2007	$ 88,348
2008	55,680
2009	37,120
Total	$181,148

14. Subsequent events

From April 1, 2007 through June 25, 2007, the Company received gross proceeds of $583,012 (net proceeds of $536,371) from the issuance of stock under the Company's equity line of credit from Dutchess.

The Company received $50,000 ($44,000 net proceeds) from an investor in the 2007 PIPE Offering.

A former officer of the Company advanced $33,179 to pay for a liability of the Company that he had personally guaranteed. This amount will be repaid to that former officer at some date in the future.

From June 13, 2007 through June 26, 2007, the Company conducted a private offering (the "Spring 2007 Offering") of up to $550,000 aggregate face amount of its convertible notes (the "Spring 2007 Notes") with a small number of accredited investors. Of this amount, $451,000 aggregate face amount of the Spring 2007 Notes were sold for an aggregate purchase price of $410,000. Therefore, while the stated interest rate on the Spring 2007 Notes is 0%, the actual interest rate on the Spring 2007 Notes is 10%. The Spring 2007 Notes mature on the first anniversary of their date of issuance. The Spring 2007 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 Spring 2007 Offering (the "Conversion Prices"). Up to 1,210,489 Conversion Shares are initially issuable at Conversion Prices of either $0.34 or $0.53 per share, depending upon which of the two closing dates of the Spring 2007 Offering the Spring 2007 Notes were sold.

Each of the investors in the Spring 2007 Offering received, for no additional consideration, a warrant (the "Spring 2007 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 2007 Notes are convertible (the "Warrant Shares"). Each Spring 2007 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 years from the date of issuance. Up to 605,242 Warrant Shares are initially issuable on exercise of the Spring 2007 Warrants.

The Company received $410,000 gross and net proceeds in the 2007 Spring Offering. The proceeds of the Spring 2007 Offering will be used for general corporate purposes and working capital.

On July 12, 2007, KZ Golf, Inc. "("KZG"), the Company's landlord, presented to the Company a Three-Day Notice to Pay or Quit, demanding payment of unpaid rent, additional rent and penalties, in the aggregate amount of $104,413 as of such date. In addition to the unpaid rent during 2007, it is apparently KZG's position that there is a discrepancy in the calculation of base rent as far back as April 1, 2004 and that a penalty of $100 per day should be imposed continuously since January 1, 2006 under the terms of a certain

provision of the sublease between the Company and KZG (the "2006 Sublease"). The Company does not admit that it owes the entire amount claimed by KZG. The Company did not exercise its option to renew the 2006 Sublease.

On June 15, 2007, the Company and Bruce H. McKinnon agreed and entered into an agreement that Mr. McKinnon would resign as Chief Executive Officer of the Company effective on the first to occur of (i) the appointment of a new Chief Executive Officer by the Board of Directors and (ii) July 31, 2007. At the time of the filing of the Form 8-K and as stated therein, it was intended that Mr. McKinnon would continue to serve as President of the Company and would continue to receive the compensation provided for in accordance with the provisions of the employment agreement dated as of October 5, 2005 between the Company and Mr. McKinnon, through December 31, 2007, the end of the term of that agreement. Additionally, as stated in the Form 8-K, Mr. McKinnon will continue to serve as a director of the Company, until he has resigned, been removed by the stockholders or not been re-elected to the Board. The Company and Mr. McKinnon have waived any claims they may have against each other and have agreed to mutual indemnification.

On July 18, 2007, Bruce H. McKinnon was removed by the Board of Directors as President and Chief Executive Officer of the Company and its wholly-owned subsidiary, STWA Asia, effective immediately. Mr. McKinnon also was removed by the Board of Directors as a director of STWA Asia, effective immediately. Mr. McKinnon will continue to serve as a director of the Company, until he has resigned, been removed by the stockholders or not been re-elected to the Board.

Also on July 18, 2007, the Board of Directors of the Company appointed Charles Blum as President and Chief Executive Officer of the Company. Mr. Blum will assume his positions within the next several days. Mr. Blum was also appointed to the Board of Directors to fill the vacancy created by the resignation on June 5, 2007 of Maj. Gen. Dennis M. Kenneally (Ret.), such appointment to take effect upon Mr. Blum's joining the Company as President and Chief Executive Officer.

Effective July 18, 2007, the Company entered into an employment agreement with Mr. Blum (the "Blum Employment Agreement"), pursuant to which Mr. Blum will serve as the Company's President and Chief Executive Officer, commencing on a mutually agreed date but not later than August 1, 2007. Pursuant to the Blum Employment Agreement, Mr. Blum's employment is for a one-year term, subject to automatic one-year extensions and provides for annual base compensation of $200,000 per year, subject to periodic review and adjustment. In addition, Mr. Blum will receive an automobile allowance of $900 per month and four weeks of paid vacation annually. Mr. Blum is entitled to participate in all employee benefit plans that the Company makes available to its employees generally; provided that if Mr. Blum elects not to participate in the Company's group medical insurance plan, he will be reimbursed in an amount equal to the lesser of (i) the premium the Company would have paid to include him as a participant in that group health insurance plan and (ii) the sums paid by him in connection with maintaining his private health insurance. The Company will also reimburse Mr. Blum the reasonable costs paid by him for maintaining DSL Internet access and other direct costs of maintaining an office at

his home, but only until such time as the Company shall provide him with an office at a location reasonably acceptable to him.

Mr. Blum is eligible to receive stock option grants under the Company's stock option plan and will receive an initial grant of options to purchase a number of shares of the Company's common stock equal to the result of 100,000 divided by the closing price of a share of the Company's common stock (the "Closing Price") on the date Mr. Blum assumes his position as Chief Executive Officer and President of the Company (the "Effective Date"). The options will vest on the first anniversary of the Effective Date and will be exercisable at the Closing Price for 10 years from the Effective Date.

Additionally, on the first anniversary of the Effective Date, Mr. Blum is eligible to receive a stock option grant under the Company's stock option plan to purchase a number of shares of the Company's common stock equal to the result of 100,000 divided by the Closing Price on the first anniversary of the Effective Date. These options will vest on the second anniversary of the Effective Date and will be exercisable at the Closing Price on the first anniversary of the Effective Date for 10 years from the date of grant.

Mr. Blum is eligible to receive an annual cash bonus in an amount equal to 2% of the Company's net profit, if any, for its most recently completed fiscal year, computed in accordance with generally accepted accounting principles applied consistently with prior periods. The bonus shall be payable, if at all, on the anniversary date of employment of each year of the term if Mr. Blum continues to be employed by the Company on the relevant payment date.

The Blum Employment Agreement also contains terms and conditions customary in agreements of this kind, including provisions relating to protection of the Company's intellectual property, non-disclosure and non-solicitation. The Blum Employment Agreement also provides, among other things, that if Mr. Blum's employment should terminate by reason of a change of control of the Company he is entitled to continue to receive compensation and participate in the Company's employee benefit plans for a period of 12 months following such termination.

As an interim matter, on July 18, 2007, the Board of Directors appointed incumbent director and former President and Chief Executive Officer Eugene E. Eichler as Acting President and Acting Chief Executive Officer of the Company. Mr. Eichler will serve in these capacities, without compensation, through July 24, 2007. Mr. Blum will assume his positions as President and Chief Executive Officer on July 25, 2007.

On July 19, 2007, KZG sued the Company in Los Angeles Superior Court, alleging unlawful detainer by the Company of its leased corporate offices at 5125 Lankershim Boulevard, North Hollywood, California and failure to pay past due rent and penalties in the aggregate amount of $104,413.20. In its complaint, KZG also seeks attorney fees. The Company does not admit that it owes the entire amount claimed by KZG.

Item 2. Management's Discussion and Analysis or Plan of Operations

This Quarterly Report on Form 10-QSB 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-KSB for the year ended December 31, 2006. 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 consolidated financial condition and 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-QSB and the consolidated financial statements and notes thereto contained in our Annual Report on Form 10-KSB for the fiscal year ended December 31, 2006.

We are a development stage company that generated our first revenues in the fourth quarter of 2006. Our focus is on research and development, and initial sales and marketing, of products incorporating our proprietary and patented technology, which is designed to reduce harmful emissions, and/or improve fuel efficiency and engine performance on equipment and vehicles driven by internal combustion engines. We have devoted the bulk of our efforts to the completion of the design, the development of our production models, testing of devices and the promotion of our products in the marketplace. We anticipate that these efforts will continue during 2007.

We face significant challenges in generating revenue and maintaining adequate working capital during the remainder of 2007 as a result of several factors. Among other things, to date our distributors, primarily located in Asia, have placed fewer orders than we had expected them to place under the terms of our distribution agreements with them. This resulted in our having less revenue and therefore less working

capital available for the further development of our business at a time when the operating costs of our business have been increasing. Additionally, certain long-term financing transactions that we were negotiating earlier this year have not materialized. In turn, this lack of adequate working capital has put additional pressures on our ability to meet our obligations as they come due, including without limitation, being able to order and pay for the tooling and manufacture of products from third parties for sale to our distributors, being able to pay for shipment and freight duties in connection with such sales, being able to make our filings with the Securities and Exchange Commission (the "SEC") in a timely manner, being able to prepare and file our proxy statement and schedule our 2007 annual meeting of stockholders, and being able to pay our professional advisors in a timely manner. We will require significant additional outside capital during 2007 in order to meet all of our obligations, produce products for sale and ship such products.

Given our current circumstances, we anticipate that revenue will remain nominal for at least the next few quarters, and unless and until we can simultaneously raise capital, reduce our expenses and generate more meaningful revenue from the sale of our products. See "Results of Operations" and "Liquidity and Capital Resources" below.

We are in the process of renegotiating certain terms of our distribution agreement with Golden Allied Enterprises (Group) Co., Ltd. ("GAE"), our distributor in China. Among other things, we currently expect that we will again defer certain of GAE's order deadlines, including GAE's revised obligation to order 100,000 units by July 31, 2007 (previously extended from July 31, 2006), by up to one additional year until July 31, 2008, and that GAE will become a non-exclusive distributor (rather than an exclusive distributor) for our ECO ChargR, MAG ChargR and Elektra products in China, while maintaining its exclusivity for the distribution of ZEFS and CAT-MATE products in China. These negotiations have not concluded and therefore are subject to change. Additionally, we have informally modified the terms of our distribution agreements with each of our distributors in China, Indonesia and Vietnam, so that none of these distributors is required to post letters of credit prior to or at the time that they place any further orders with us. These modifications may increase somewhat our exposure in terms of being paid in a timely fashion for products we ship to these distributors.

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 the three-month period ended March 31, 2007 and subsequent to the end of the three-month period ended March 31, 2007, and we will need to raise substantial additional capital during 2007, and possibly beyond, to fund our sales and marketing efforts, the manufacture of products to our distributors, continuing research and development, and certain other expenses, unless and until our revenue base grows sufficiently.

Results of Operations

Revenues were $22,000 for the three-month period ended March 31, 2007, compared to $0 for the three-month period ended March 31, 2006. Cost of goods sold were $5,360 for the three-month period ended March 31, 2007, compared to $0 for the three-month period ended March 31, 2006.

Operating expenses were $1,279,775 for the three-month period ended March 31, 2007, compared to $1,755,438 for the three-month period ended March 31, 2006, a decrease of $475,663. This decrease is attributable to a decrease in non-cash expenses of $832,797, offset by an increases in cash expenses of $357,134. Specifically, the non-cash decrease is attributable to the revaluation of options and warrants given to employees and consultant ($863,317), offset by an increase in depreciation ($30,520). Increases in cash expenses are attributable to increases in consulting and professional fees ($173,633), travel expenses ($40,557), salaries and benefits ($34,138), exhibits and trade show ($24,562), office and other expenses ($68,176), and corporate expenses ($16,068).

Research and development expenses were $340,452 for the three-month period ended March 31, 2007, compared to $57,294 for the three-month period ended March 31, 2006, an increase of $283,158. This increase is attributable to an increase in product testing, research and supplies ($279,573), offset by a credit from RAND Corporation ($50,000), and decreases in consulting fees ($31,683) and travel and related expenses ($14,732).

Other expense for the three-month period ended March 31, 2007 were $309,774, compared to $1,184,573 for the three-month period ended March 31, 2006, a decrease of $874,799. This decrease is attributable to decreases in non-cash interest expense ($929,343), cash interest expense ($47,559) and other income ($104), offset by an increase in financing costs ($102,207).

We had a net loss of $1,914,161, or $0.05 per share, for the three-month period ended March 31, 2007, compared to a net loss of $2,998,105, or $0.10 per share, for the three-month period ended March 31, 2006. We expect to incur additional net loss in the fiscal year ending December 31, 2007, 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

We have incurred negative cash flow from operations in the developmental stage since our inception in 1998. As of March 31, 2007, we had cash of $92,336 and an accumulated deficit of $32,341,758. Our negative operating cash flow in the three-month period ended March 31, 2007 was funded primarily through the sale of convertible notes, as well as sales of our stock by Dutchess Private Equity Fund, LLP ("Dutchess") under our equity line of credit.

The condensed consolidated financial statements accompanying this Quarterly Report have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of liabilities and commitments in the normal course of our business. As reflected in the accompanying condensed consolidated financial statements, we had a net loss of $1,914,161 and a negative cash flow from operations of $1,320,525 for the three-month period ended March 31, 2007, and a stockholders' deficiency of $1,804,881 as of March 31, 2007, and a net loss of $10,181,523 and a negative cash flow from operations of $5,197,587 for the year ending December 31, 2006, and a stockholders' deficiency of $896,694 as of December 31, 2006. These factors raise substantial doubt about our ability to continue as a going concern. Our ability to continue as a going concern is dependent on our ability to raise additional funds, generate revenue and implement our business plan. The financial statements do not include any adjustments that might be necessary if we are unable to continue as a going concern.

Our current liabilities greatly exceed our assets and we are unable to meet our obligations as they become due. Additionally, we have been unable to make certain payments to various parties for amounts currently owed to them.

We face significant challenges in generating revenue and maintaining adequate working capital during the remainder of 2007 as a result of several factors. Among other things, to date our distributors, primarily located in Asia, have placed fewer orders than we had expected them to place under the terms of our distribution agreements with them. This resulted in our having less revenue and therefore less working capital available for the further development of our business at a time when the operating costs of our business have been increasing. Additionally, certain long-term financing transactions that we were negotiating earlier this year have not materialized. In turn, this lack of adequate working capital has put additional pressures on our ability to meet our obligations as they come due, including without limitation, being able to order and pay for the tooling and manufacture of products from third parties for sale to our distributors, being able to pay for shipment and freight duties in connection with such sales, being able to make our filings with the SEC in a timely manner, being able to prepare and file our proxy statement and schedule our 2007 annual meeting of stockholders, and being able to pay our professional advisors and outside consultants in a timely manner. We will require significant additional outside capital during 2007 in order to meet all of our obligations, produce products for sale and ship such products.

During the three-month period ended March 31, 2007, we raised an aggregate $1,259,043 gross proceeds ($1,184,320 net proceeds) from the sale of our stock and the issuance of debt, as follows:

- Gross and net proceeds of $500,000 from the issuance of a convertible note and related warrants in a private offering to Morale Orchard, LLC ("Morale") on January 10, 2007. The face amount of the note is $612,500 and is due on January 9, 2008.
- Gross proceeds of $350,000 (net proceeds of $30,000) from the issuance of notes and related warrants in a private offering (the "2007 PIPE Offering") conducted by Spencer Clarke, LLC ("Spencer Clarke"), as exclusive placement agent, that began in January 2007 and was completed on April 27, 2007.
- Gross proceeds of $409,043 (net proceeds of $376,320) from the issuance of stock under our equity line of credit from Dutchess.

Subsequent to end of the three-month period ended March 31, 2007 and through June 26, 2007, we raised an aggregate $1,043,012 gross proceeds ($990,371 net proceeds) from the sale of our stock and the issuance of debt, as follows:

- Gross proceeds of $50,000 (net proceeds of $44,000) from the issuance of notes and related warrants in the 2007 PIPE Offering.
- Gross proceeds of $583,012 (net proceeds of $536,371) from the issuance of stock under our equity line of credit from Dutchess.
- Gross and net proceeds of $410,000 from the issuance of convertible notes and related warrants in a private offering (the "Spring 2007 Offering").

Details of Recent Financing Transactions

Equity Line of Credit. In September 2006, to address our longer-term capital needs, we entered into what is sometimes referred to as an equity line of credit arrangement with Dutchess. Specifically, we entered into an investment agreement, pursuant to which Dutchess is committed to purchase up to $10,000,000 of our common stock over the 36-month term of the investment agreement. We are not obligated to request any portion of the $10,000,000.

In connection with the equity line of credit, we filed a Registration Statement with the SEC (the "Dutchess Registration Statement") on October 6, 2006 to register 7,000,000 shares of Common Stock that we may issue under the equity line of credit and the Dutchess Registration Statement was declared effective by the SEC on October 30, 2006.

Under the line of credit we may, but are not obligated to, put shares of our stock to Dutchess from time to time over a 36-month period, at a purchase price calculated at 97% of the lowest best closing bid for our common stock for the five trading days following our put notice to Dutchess. Because the price of our common stock fluctuates and the number of shares of our common stock, if any, that we may issue, should we exercise our put rights under the equity line of credit, will vary, we do not know how many shares, if any, we will actually issue under the equity line of credit. If we put more than the amount that would require us to issue the 7,000,000 shares that we have registered with the SEC, we would be required to file a new registration statement with regard to the excess number of shares and have it declared effective by the SEC, before we could make further puts under the equity line of credit.

The actual number of shares that we may issue pursuant to the equity line of credit is not determinable as it is based on the market price of our common stock from time to time and the number of shares we desire to put to Dutchess. Under the terms of the equity line of credit, Dutchess may not own more than 4.99% of our issued and outstanding stock at any one time.

As we draw down on the equity line of credit, more shares will be sold into the market by Dutchess. These additional shares could cause our stock price to drop. In turn, if the stock price drops and we make more drawdowns on the equity line of credit, more shares will come into the market, which could cause a further drop in the stock price. You should be aware that there is an inverse relationship between our stock price and the number of shares to be issued pursuant to the equity line of credit. If our stock price declines, we will be required to issue a greater number of shares under the equity line of credit. We have no obligation to utilize the full amount available under the equity line of credit.

For purposes of the Dutchess Registration Statement, we assumed that we would put $9,913,400, or all 7,000,000 shares, based on a closing price of our common stock on September 20, 2006 of $1.46 per share, less the 3% discount applicable to the price per share that Dutchess would pay under the terms of the equity line of credit. However, this may not in fact be the case. We would only be able to put a total of approximately $5,908,000 for the same 7,000,000 shares, based on a more current closing price of our Common Stock on January 11, 2007 of $0.87 per share, less the 3% discount applicable to the price per share that Dutchess would pay under the terms of the equity line of credit.

In part because of the drop of our stock price since the establishment of the equity line of credit, we have not used the maximum amount of the equity line of credit to date that we could have used. Additionally, as our business expands and new opportunities, technologies and markets present themselves, our capital requirements are expected to increase.

Morale Transaction. On December 5, 2006, we entered into a Note Purchase Agreement (the "Note Purchase Agreement") with Morale. The entire equity interest in Morale is beneficially owned by Leodis Matthews, who is the Company's litigator through his law firm. 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. 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.

Each of the Morale Notes is convertible into shares of our Common Stock at a per share conversion price initially equal to the closing price of a share of our Common Stock on the trading day prior to the date of issuance of such Morale Note. The conversion right is exercisable during the period commencing 90 days prior to the maturity of each Morale Note. Concurrently with the issuance of a Morale Note, for no additional consideration, Morale will acquire Morale Warrants to purchase a number of shares of our Common Stock equal to 50% of the number of shares of our Common Stock initially issuable on conversion of the associated Morale Note. The Morale Warrants become exercisable 180 days after the date of their issuance.

The Morale Note purchased by Morale on December 5, 2006 is convertible at the rate of $0.85 per share into 720,588 shares of our Common Stock and the Morale Warrants are exercisable at $0.85 per share for 360,294 shares of our Common Stock. The Morale Note purchased by Morale on January 10, 2007 is convertible at the rate of $0.70 per share into 875,000 shares of our Common Stock and the Morale Warrants are exercisable at $0.70 per share for 437,500 shares of our Common Stock.

Repayment of each Morale Note is to be made monthly, at an amount equal to at least $3,750 for each Morale Note. Additional payments may be made prior to maturity with no prepayment penalties. In the event the Company has not repaid each Morale Note in full by the anniversary date of its issuance, the remaining balance shall be increased by 10% as an initial penalty, and the Company shall pay additional interest of 2.5% per month, compounded daily, for each month until such Morale Note is paid in full.

Morale has piggyback registration rights pursuant to which Morale may require the Company to include the shares of our Common Stock issuable upon conversion of the Morale Notes and exercise of the Morale Warrants in certain future registration statements we may elect to file, subject to the right of the Company and/or its underwriters to reduce the number of shares to be included in such a registration in good faith based on market or other conditions.

2007 PIPE Offering. From January 13 through April 27, 2007, the Company conducted an offering (the "2007 PIPE Offering"), through Spencer Clarke, as exclusive placement agent, of up to $2,000,000 principal amount of its 10% convertible notes (the "2007 PIPE Notes"). Interest on the 2007 PIPE Notes, at a rate of 10% per annum, is payable quarterly. The Notes are due nine months from date of issuance. The Notes are convertible into shares of Common Stock at an initial conversion price of $0.70

per share (the "Conversion Shares"). The Company raised $400,000 gross proceeds ($352,000 net proceeds) in the 2007 PIPE Offering.

The Company has the right to redeem any or all of the outstanding 2007 PIPE Notes in its sole discretion anytime after the termination of the 2007 PIPE Offering and prior to the maturity date of the 2007 PIPE Notes. The redemption price shall be the face amount of the redeemed Notes plus accrued and unpaid interest thereon. Subject to the following sentence, at any time prior to the maturity date of the 2007 PIPE Notes, for each additional $1,000,000 of gross proceeds raised from one or more offerings of the Company's equity or quasi-equity securities, the Company shall redeem 2007 PIPE Notes with a minimum face value of $500,000 together with accrued and unpaid interest, until the entire outstanding 2007 PIPE Note is redeemed. Certain financings that the Company may conduct outside of North America and only up to a maximum of UK £15,000,000 in the aggregate, are exempt from this provision to redeem the 2007 PIPE Notes in whole or in part.

Investors in the 2007 PIPE Offering received, for no additional consideration, a warrant (the "2007 PIPE Warrant"), entitling the holder to purchase a number of shares of the Company's common stock equal to 150% of the number of shares of common stock into which the 2007 PIPE Notes are convertible (the "Warrant Shares"). The 2007 PIPE Warrant will be exercisable on a cash basis only and will have registration rights. The 2007 PIPE Warrant is exercisable at an initial price of $1.00 per share, and is exercisable immediately upon issuance and for a period of three years from the date of issuance.

Promptly, but no later than 90 days following the closing date of the 2007 PIPE Offering, the Company is required to file a registration statement with the SEC to register the Conversion Shares and the Warrant Shares. The Company shall use its best efforts to ensure that such registration statement is declared effective within 120 days after filing. Due to the Company's current cash flow and liquidity difficulties, including its inability to file all of its reports with the SEC in a timely manner, the Company was unable to meet its obligations to file the registration statement required under the terms of the 2007 PIPE Offering in a timely manner, the deadline for which was June 27, 2007. The Company has begun discussions with Spencer Clarke, on behalf of the holders of the 2007 PIPE Notes, for an extension of time to file the registration statement, but it is not known what, if any, arrangements will be made in this matter.

2007 Spring Offering. From June 13, 2007 through June 26, 2007, the Company conducted a private offering (the "Spring 2007 Offering") of up to $550,000 aggregate face amount of its convertible notes (the "Spring 2007 Notes") with a small number of accredited investors. Of this amount, $451,000 aggregate face amount of the Spring 2007 Notes were sold for an aggregate purchase price of $410,000. Therefore, while the stated interest rate on the Spring 2007 Notes is 0%, the actual interest rate on the Spring 2007 Notes is 10%. The Spring 2007 Notes mature on the first anniversary of their date of issuance. The Spring 2007 Notes are convertible, at the option of the noteholders, 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 Spring 2007 Offering (the "Conversion Prices"). Up to 1,210,489 Conversion Shares are initially issuable at Conversion Prices of either $0.34 or $0.53 per share, depending upon which of the two closing dates of the Spring 2007 Offering the Spring 2007 Notes were sold.

Each of the investors in the Spring 2007 Offering received, for no additional consideration, a warrant (the "Spring 2007 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 2007 Notes are convertible (the "Warrant Shares"). Each Spring 2007 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 years from the date of issuance. Up to 605,242 Warrant Shares are initially issuable on exercise of the Spring 2007 Warrants.

The Company received $410,000 gross and net proceeds in the 2007 Spring Offering. The proceeds of the Spring 2007 Offering will be used for general corporate purposes and working capital.

With the exception of some of the proceeds of the Spring 2007 Offering, the net proceeds of all of the offerings discussed above are largely exhausted and we have cash on hand to meet expenses only for a short period of time. In order to fund our capital needs for the foreseeable future, including the operations of our business, and the repayment of our outstanding Bridge Notes and our 2007 PIPE Notes, both of which series of notes are due by the end of 2007, and the Morale Orchards Notes, which are due in December 2007 and January 2008, as well as the Spring 2007 Notes, which are due in June 2008, we must raise substantial additional funds, in addition to the funds required to continue to operate our business, including without limitation the expenses we will incur in connection with the license and research and development agreements with Temple University, costs associated with product development and commercialization of the ELEKTRA technology, costs to manufacture and ship our products, costs to design and implement an effective system of internal controls and disclosure controls and procedures, costs of maintaining our status as a public company by filing periodic reports with the SEC, and costs required to protect our intellectual property. In addition, as discussed below, we have substantial contractual commitments, including without limitation salaries to our executive officers pursuant to employment agreements, certain severance payments to a former officer and consulting fees, during the remainder of 2007 and beyond.

In light of the Company's financial commitments over the next several months and its liquidity constraints, we are implementing cost reduction measures in all areas of operations, including but not limited to personnel lay-offs and/or reductions in work, reductions in marketing and advertising, deferral of placing orders to manufacturers of our ECO ChargR and MAG ChargR products for sale to our existing distributors, reductions in research and development and product development of ELEKTRA products, and reductions of certain other expenses. We intend to review these measures on an ongoing basis and make additional decisions as may be required.

We my continue to use our equity line of credit for some of our additional requirements for 2007. However, the equity line of credit will not be sufficient to meet all of our current liabilities and other obligations in 2007. Among other things, the thin trading of our common stock may limit our ability to use the equity line of credit without adversely affecting the price of our common stock. Therefore, in addition to the recently-completed Spring 2007 Offering, the Company is actively pursuing additional financing alternatives, but no commitments have been received and, accordingly, no assurance can be given that any financing will be available or, if available, that it will be on terms that are satisfactory to the Company. At present, we have relatively few financing options available to us.

Contractual Obligations

The following table discloses our contractual commitments for future periods. Long-term commitments are comprised operating leases and minimum guaranteed compensation payments under employment and other agreements. See Note 13 to Notes to Condensed Consolidated Financial Statements.

Year ending December 31,	Operating Leases(1)	Guaranteed Payments
2007	$ 149,156(1)	$ 1,585,338(3)
2008	$ 55,680	$ 300,000(4)
2009	$ 37,120(2)	$ 75,000(5)
	$ 241,956	$ 1,960,338

(1) This amount includes, with respect to the North Hollywood facility: (i) unpaid base rent from February 2007 through July 2007, in the aggregate amount of $43,032; (ii) $963 with respect to partially unpaid rent for January 2007; and (iii) a $100 per day penalty from January 1, 2006 through July 31, 2007, in the aggregate amount of $57,700, for unpaid rent and/or unpaid late fees claimed by the landlord, for which the landlord claims we are liable pursuant to a certain provision of the sublease. We believe that there are numerous reasons why we should not be liable for most, or all, of any such penalties; however, no assurance can be given that we would not be liable for any or all of such penalties. We have not renewed the sublease for our corporate offices at North Hollywood, California, which expires on July 31,

2007. See Part II, Item 5, “Other Information” and Notes 13 and 14 to Notes to Condensed Consolidated Financial Statements, for additional information regarding this matter. We have assumed that we will renew the lease for our engineering, production and testing facility at Morgan Hill, California when it expires on August 31, 2007, on the existing terms, including rent, for an additional two-year period, expiring on July 31, 2009. We currently intend to renew this lease.

(2) Does not include rent for (i) our corporate offices at North Hollywood, California beyond July 31, 2007 or (ii) our engineering, production and testing facility at Morgan Hill, California beyond August 31, 2009, which are the expiration dates of the respective renewal terms for those two leases.

(3) Consists of an aggregate $545,600 in total compensation, including base salary and certain contractually-provided benefits, to two executive officers, pursuant to employment agreements that expire on December 31, 2007, and to one additional officer, pursuant to an employment agreement that expires on February 28, 2008; $385,000 in licensing fees to Temple University; $322,800 in severance payments to a former officer; $240,000 in consulting fees to Spencer Clarke; and $91,938 in fees to certain other consultants.

(4) Consists of licensing fees in the amount of $290,000 due to Temple University; and salary in the amount of $10,000 for two months to an officer, pursuant to an employment agreement that expires on February 28, 2008. Does not include compensation to our two executive officers, whose employment agreements expire on December 31, 2007.

(5) Consists of licensing fees due to Temple University. Does not include compensation to our two executive officers, whose employment agreements expire on December 31, 2007.

Licensing Fees to Temple University. 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.

We have entered into two license agreements with Temple University, one covering Temple University ‘s current patent application concerning certain electric field effects on gasoline, kerosene and diesel fuel particle size distribution, and the other covering Temple University’s current patent application concerning electric field effects on crude oil viscosity, and any and all United States and foreign patents issuing in respect of the technologies described in such applications (individually, a “License Agreement” and collectively, the “License Agreements”). Initially, the License Agreements are exclusive and the territory licensed to the Company is worldwide. Pursuant to the License Agreements, the Company will pay Temple University (i) license fees in the aggregate amount of $250,000.00, payable in three installments of $100,000.00, the first installment of which was paid in March 2007, and $75,000.00 on each of February 2, 2008 and February 2, 2009, respectively; and (ii) annual maintenance fees of $125,000 annually commencing 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 two 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.

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, 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) flow in pipelines. Pursuant to the R&D Agreement, we will make payments to Temple University in the aggregate amount of $500,000.00, payable in eight non-refundable

installments commencing with $123,750, which was paid in March 2007, and $53,750 every three months thereafter until paid in full. 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.

We are current in our payments to Temple University under the License Agreements through March 31, 2007. However, a payment of $53,750 with respect to the R&D Agreement, which was due in June 2007, has not yet been made to Temple University.

Severance Payments to Former Officers. On November 9, 2006, Eugene E. Eichler resigned as our Chief Executive Officer and Chief Financial Officer, due to a medical disability. Mr. Eichler's resignation as Chief Executive Officer took effect on November 20, 2006 and his resignation as Chief Financial Officer took effect on the appointment of his successor on January 8, 2007.

Under the terms of Mr. Eichler's separation as an officer of the Company, he is entitled to be paid out the remainder of the cash portion of his employment agreement, at a rate of $300,000 per annum, through December 31, 2007, in accordance with the Company's normal pay policies. Options granted to him in February 2006 have been accelerated and fully vested on November 20, 2006; additionally, Mr. Eichler will have until November 20, 2007 to exercise such options. Mr. Eichler is also entitled to receive a stock option grant in 2007 equal to the lesser of (i) the number of stock options Mr. Eichler was granted in 2006 or (ii) the highest number of options granted to any of the then Chief Executive Officer, President or Chief Financial Officer on an annualized basis, on terms no less favorable as granted to such person; provided, however, that such options to be granted to Mr. Eichler shall be fully vested upon grant and shall be exercisable for one year from the date of grant. The Company and Mr. Eichler have waived any claims they may have against each other and have agreed to mutual indemnification.

Of the payments we are required to make under this arrangement, we have paid $25,000 for January 2007 and have accrued but not yet paid $50,000 through March 31, 2007, by agreement between the Company and Mr. Eichler.

On June 15, 2007, the Company and Bruce H. McKinnon agreed and entered into an agreement that Mr. McKinnon would resign as Chief Executive Officer of the Company effective on the first to occur of (i) the appointment of a new Chief Executive Officer by the Board of Directors and (ii) July 31, 2007. Mr. McKinnon will continue to serve as President of the Company and to receive the compensation provided for in accordance with the provisions of the Employment Agreement between Mr. McKinnon and the Company dated as of October 5, 2005 through December 31, 2007, the end of the term of that agreement. In addition Mr. McKinnon will continue to serve as a Director of the Company, until he has resigned, been removed by the stockholders or not been re-elected to the Board. The Company and Mr. McKinnon have waived any claims they may have against each other and have agreed to mutual indemnification.

On July 18, 2007, Bruce H. McKinnon was removed by the Board of Directors as President and Chief Executive Officer of the Company and its wholly-owned subsidiary, STWA Asia Pte. Limited ("STWA Asia"), effective immediately. See Part II, Item 5, "Other Information".

Transactions with Spencer Clarke. Spencer Clarke has served as our exclusive placement agent in recent offerings of our securities. We also have retained Spencer Clarke as a consultant to the Company, for which it will be separately compensated.

We entered into a consulting agreement dated January 4, 2007 with Spencer Clarke (the "Consulting Agreement"), pursuant to which Spencer Clarke has agreed that for a twelve-month period beginning January 15, 2007, Spencer Clarke will provide us with financial consulting services (including but not limited to executive search, strategic partnerships, research on new markets, strategic visibility, etc) to help further develop our strategic business plan.

For Spencer Clarke's services, we have agreed to pay Spencer Clarke a non-refundable fee of $20,000 per month, payable in advance. The first payment, in the amount of $60,000 and covering three months, was payable by us on March 15, 2007. We will also reimburse Spencer Clarke for expenses they incur in connection with the performance of their services under the Consulting Agreement, provided that expenses in excess of $2,000 require our prior approval before they may be incurred by Spencer Clarke.

We have agreed to indemnify Spencer Clarke against any losses, claims, damages or liabilities to which Spencer Clarke may become subject arising out of or in connection with the services they render under the Consulting Agreement, unless it is finally judicially determined that such losses, claims, damages or liabilities arose primarily out of the gross negligence or bad faith of Spencer Clarke. We have also agreed to reimburse Spencer Clarke immediately for any legal or other expenses they reasonably incur in connection with investigating, preparing to defend or defending any lawsuits or other proceedings arising out of or in connection with their rendering of services under the Consulting Agreement; provided, however, that in the event of a final judicial determination that the alleged losses, claims, damages or liabilities arose primarily out of the gross negligence or bad faith of Spencer Clarke, Spencer Clarke will remit to us any amounts reimbursed, but the amount which Spencer Clarke must remit in such event is limited to the fee payable by us to Spencer Clarke under the Consulting Agreement.

To date, we have not made any payments under the Consulting Agreement and have accrued $60,000 through March 31, 2007 with respect to this obligation.

Critical Accounting Policies and Estimates

Our discussion and analysis of our 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 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

The Company has adopted Staff Accounting Bulletin 104, "Revenue Recognition" and therefore recognizes 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
- Collectibility is reasonably assured.

The Company contract manufactures fixed magnetic field products and sells them to various original equipment manufacturers in the motor vehicle and small utility motor markets. The Company negotiates 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, the Company recognizes the revenue associated with the sale of the products to the customer.

Long-lived assets

The Company accounts 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. The Company periodically reviews the carrying values of long-lived assets to determine whether or not an impairment to such value has occurred. No impairments were recorded for the year ended December 31, 2006. The Company recorded an impairment of approximately $505,000 during the period from inception (February 18, 1998) through December 31, 2006.

Stock-Based Compensation

Through December 31, 2005, the Company accounted for stock-based compensation to employees and directors using the intrinsic value method in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25") and elected to provided the pro-forma disclosure requirements of Statements of Financial Accounting Standards No. 123, "Share-Based Payment," ("SFAS 123").

Under the intrinsic value method, the Company recognized share-based compensation equal to the award's intrinsic value at the time of grant over the requisite service periods using the straight-line method. Forfeitures were recognized as incurred. The fair values of the awards were not expensed over the requisite service period. Had the Company recognized such fair value expense under SFAS 123 for the year ended December 31, 2005, the Company would have recorded additional compensation expense of $861,637.

The following table illustrates the effect on net loss and loss per share if the Company had applied the fair value recognition provisions of SFAS 123 to stock-based awards granted under the Company's stock option plans for the years ended December 31, 2006 and 2005 and for the period from inception (February 18, 1998) to December 31, 2006. For purposes of this pro-forma disclosure, the fair value of the options is estimated using the Black-Scholes-Merton option-pricing formula ("Black-Scholes model") and amortized to expense over the options' requisite service periods (vesting periods).

	December 31, 2005	Cumulative Since Inception
Net loss, as reported	$ (3,115,186)	$(30,427,597)
Add: total fair value method stock-based employee compensation expense	(1,039,268)	(5,010,310)
Less: deferred compensation amortization for below market employee options	177,631	3,060,744
Pro forma net loss	$ (3,976,823)	$(32,377,163)
Net loss per share:		
As reported — basic and diluted	$ (0.08)	
Pro forma — basic and diluted	$ (0.10)	

On January 1, 2006, the Company adopted Statements of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment," ("SFAS 123R") which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors based on estimated fair values. SFAS 123R supersedes the Company's previous accounting under APB 25 for periods beginning in fiscal 2006. In March 2005, the SEC issued Staff Accounting Bulletin No. 107 ("SAB 107") relating to SFAS 123R. The Company has applied the provisions of SAB 107 in its adoption of SFAS 123R.

The Company adopted SFAS 123R using the modified prospective transition method, which requires the application of the accounting standard as of January 1, 2006, the first day of the Company's fiscal year 2006. The Company's financial statements as of and for the year ended December 31, 2006 reflect the impact of SFAS 123R. In accordance with the modified prospective transition method, the Company's financial statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS 123R. Stock-based compensation expense recognized under SFAS 123R for employee and directors for the year ended December 31, 2006 was $2,253,263. Basic and diluted loss per share for the year ended December 31, 2006 would have been ($0.21) per share, if the Company had not adopted SFAS 123R, compared to reported basic and diluted loss per share of ($0.28) per share.

SFAS 123R requires companies to estimate the fair value of share-based payment awards to employees and directors on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in the Company's Statements of Operations. Stock-based compensation expense recognized in the Statements of Operations for the year ended December 31, 2006 included compensation expense for share-based payment awards granted prior to, but not yet vested as of January 1, 2006 based on the grant date fair value estimated in accordance with the pro-forma provisions of SFAS 123 and compensation expense for the share-based payment awards granted subsequent to January 1, 2006 based on the grant date fair value estimated in accordance with the provisions of SFAS 123R. For stock-based awards issued to employees and directors, stock-based compensation is attributed to expense using the straight-line single option method, which is consistent with how the prior-period pro formas were provided. As stock-based compensation expense recognized in the Statements of Operations for the second quarter of fiscal 2006 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. SFAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. In our pro-forma information required under SFAS 123 for the periods prior to fiscal 2006, the Company accounted for forfeitures as they occurred.

The Company's determination of fair value of share-based payment awards to employees and directors on the date of grant using the Black-Scholes model, which is affected by the Company's stock price as well as assumptions regarding a number of highly complex and subjective variables. These variables include, but are not limited to our expected stock price volatility over the term of the awards, and actual and projected employee stock option exercise behaviors.

The Company has elected to adopt the detailed method provided in SFAS 123R for calculating the beginning balance of the additional paid-in capital pool ("APIC pool") related to the tax effects of employee stock-based compensation, and to determine the subsequent impact on the APIC pool and Statements of Cash Flows of the tax effects of employee stock-based compensation awards that are outstanding upon adoption of SFAS 123R.

As of December 31, 2005, there was $142,187 of total unrecognized compensation costs recognized within the shareholders' deficit related to non-vested share-based compensation arrangements granted under the 2004 Stock Option Plan. See Note 10 to Notes to Condensed Consolidated Financial Statements. This cost was written off against Additional Paid-in Capital when SFAS 123R was adopted.

The Company accounts for stock option and warrant grants issued to non-employees for goods and services using the guidance of SFAS 123 and Emerging Issues Task Force ("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," whereby the fair value of such option and warrant grants is determined using the Black-Scholes model at the earlier of the date at which the non-employee's performance is completed or a performance commitment is reached.

Business and credit concentrations

The Company's cash balances in financial institutions at times may exceed federally insured limits. As of March 31, 2007 and December 31, 2006, before adjustments for outstanding checks and deposits in transit, the Company had $92,336 and $244,228, respectively, on deposit with three banks. The deposits are federally insured up to $100,000 on each bank.

Inventories

Inventories are valued at the lower of cost (first-in, first-out) or market and primarily consist of finished goods.

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 condensed consolidated financial statements. Actual results could differ from those estimates.

Fair value of financial instruments

The carrying amounts of financial instruments, including cash, accounts payable and accrued expenses, convertible notes, and payables to related parties approximate fair value because of their short maturity as of March 31, 2007 and December 31, 2006.

Recent Accounting Pronouncements

Statement No. 157

In September 2006, the FASB issued Statement No. 157, "Fair Value Measurements" ("SFAS 157"), SFAS 157 establishes a formal framework for measuring fair value under GAAP. It defines and codifies the many definitions of fair value included among various other authoritative literature, clarifies and, in some instances, expands on the guidance for implementing fair value measurements, and increases the level of disclosure required for fair value measurements. Although SFAS 157 applies to and amends the provisions of existing FASB and AICPA pronouncements, it does not, of itself, require any new fair value measurements, nor does it establish valuation standards. SFAS 157 applies to all other accounting pronouncements requiring or permitting fair value measurements, except for; SFAS 123R, share-based payment and related pronouncements, the practicability exceptions to fair value determinations allowed by various other authoritative pronouncements, and AICPA Statements of Position 97-2 and 98-9 that deal with software revenue recognition. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years.

Interpretation No. 48

Effective January 1, 2007, the Company adopted Financial Accounting Standards Board Interpretation No 48, "Accounting for Uncertainty in Income Taxes — an interpretation of FASB Statement No 109, "Accounting for Income Taxes ("FIN 48")." FIN 48 addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under FIN 48, the Company may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position should be measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. FIN 48 also provides guidance on de-recognition, classification, interest and penalties on income taxes, accounting in interim periods and requires increased disclosures. At the date of adoption, and as of March 31, 2007, the Company does not have a liability for unrecognized tax benefits.

The Company files income tax returns in the U.S. federal jurisdiction and the state of California. The Company is subject to U.S. federal or state income tax examinations by tax authorities for years after 2002. During the periods open to examination, the Company has net operating loss and tax credit carry forwards for U.S. federal and state tax purposes that have attributes from closed periods. Since these net operating losses and tax credit carry forwards may be utilized in future periods, they remain subject to examination. The Company's policy is to record interest and penalties on uncertain tax provisions as income tax expense. As of March 31, 2007, The Company has no accrued interest or penalties related to uncertain tax positions. The Company believes that it has not taken any uncertain tax positions that would impact its condensed consolidated financial statements as of March 31, 2007. Also as of the date of adoption, and as of March 31, 2007, the Company does not have a liability for unrecognized tax benefits.

EITF 00-19-2

Effective in the first quarter of 2007 the Company adopted FASB Staff Position No. EITF 00-19-2, “Accounting for Registration Payment Arrangements” issued on December 21, 2006 (“FSP 00-19-2”). FSP 00-19-2 specifies that the contingent obligation to make future payments or otherwise transfer consideration under a registration payment, whether issued as a separate agreement or included as a provision of a financial instrument or other agreement, should be separately recognized and measured in accordance with FASB Statement No. 5, “Accounting for Contingencies.” For registration payment arrangements and financial instruments subject to those arrangements that were entered into prior to the issuance of EITF 00-19-2, this guidance is effective for financial statements issued for fiscal years beginning after December 15, 2006 and interim periods within those fiscal years.

Item 3. Controls and Procedures

a) 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 Quarterly Report on Form 10-QSB. 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(e) and 15d-15(e) 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. These matters persist despite our having developed and partially implemented a plan to ensure that all information will be recorded accurately, processed effectively, summarized promptly and reported on a timely basis. Our plan to date has involved, in part, reallocation of responsibilities among officers, various other personnel and some of our directors, and hiring additional personnel. We began to implement this plan during 2005, including the hiring in August 2005 of a Controller who is a Certified Public Accountant. However, 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 a new part-time Chief Financial Officer and a full-time Controller, although the latter is not a Certified Public Accountant. One of several specific additional steps that the Company believes it must undertake is to retain a consulting firm to, among other things, design and implement adequate systems of accounting and financial statement disclosure controls during the current fiscal year to comply with the requirements of the SEC. We believe that the ultimate success of our plan to improve our disclosure controls and procedures 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.

(b) *Changes in internal control over financial reporting.* There was no change in our internal control over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-QSB that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II

Item 1. Legal Proceedings

Litigation Involving Jeffrey A. Muller

On December 19, 2001, the SEC filed civil charges in the United States Federal District Court, Southern District of New York, against us, our former President and then sole director Jeffrey A. Muller, and others, alleging that we and the other defendants were engaged in a fraudulent scheme to promote our 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 our corporation, which was then controlled by Mr. Muller. On March 22, 2002, we 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, we were not required to admit fault and did not pay any fines or restitution. The SEC's charges of fraud and stock manipulation continue against Mr. Muller and others.

On July 2, 2002, after an investigation by our newly constituted board of directors, we 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 our stock and other transactions occurring between 1998 and 2002. Among other things, we alleged that Mr. Muller and certain others sold Company stock without providing adequate consideration to us; 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 our 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 our 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 us, from selling or transferring any of our stock that they may own or control, or from taking any action to injure us or our business and from having any direct contact with our shareholders. The injunctive order also prevents Mr. Muller from engaging in any effort to exercise control over our corporation and from serving as an officer or director of our company. While we believe that we have valid claims, there can be no assurance that an adverse result or settlement would not have a material adverse effect on our financial position or cash flow.

In the course of the litigation, we have obtained ownership control over Mr. Muller's claimed patent rights to the ZEFS device. Under a Buy-Sell Agreement between Mr. Muller and dated December 29, 1998, Mr. Muller, who was listed on the ZEFS devise patent application as the inventor of the ZEFS device, purported to grant us all international marketing, manufacturing and distribution rights to the ZEFS device. Those rights were disputed because an original inventor of the ZEFS device contested Mr. Muller's legal ability to have conveyed those rights.

In Australia, Mr. Muller entered into a bankruptcy action seeking to overcome our claims for ownership of the ZEFS device. In conjunction with these litigation proceedings, a settlement agreement was reached with the bankruptcy trustee whereby the $10 per unit royalty previously due to Mr. Muller under his contested Buy-Sell Agreement was terminated and replaced with a $.20 per unit royalty payable to the bankruptcy trustee. On November 7, 2002, under a settlement agreement executed with Mr. Muller's bankruptcy trustee, the trustee transferred to us all ownership and legal rights to this international patent application for the ZEFS device.

Both the SEC and we filed Motions for Summary Judgment contending that there are no material issues of fact in contention and as a matter of law, the Court should grant a judgment against Mr. Muller and the cross-defendants.

Mr. Muller and several of the defendants filed a Motion to Dismiss the complaint filed by us and moved for summary judgment in their favor. On December 28, 2004, Judge George B. Daniels, denied the cross-defendants' motion to dismiss our cross-complaint, denied the defendants' request to vacate the July 2, 2002 preliminary injunction and denied their request for damages against us. The court also refused to grant a summary judgment in favor of the cross-defendants and dismissed Mr. Muller's claims against us for indemnification for his legal costs and for damages resulting from the litigation. Neither Mr. Muller nor any of the cross-defendants have filed any cross-claims against us and we are not exposed to any liability as a result of the litigation, except for possibly incurring legal fees and expenses should we lose the litigation.

On November 16, 2005, the Court granted the SEC's motion for summary judgment. In granting the motion, the Court has 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 our stock that he still owns and directed the Company to cancel any issued and outstanding shares of our stock still owned by Mr. Muller. Mr. Muller was also ordered to disgorge to the SEC unlawful profits in the amount of $7.5 million and a pay a civil penalty in the amount of $100,000. Acting in accordance with the ruling and decision of the Court, we have canceled (i) 8,047,403 shares of its common stock held by Mr. Muller and/or his affiliates, (ii) options to acquire an additional 10,000,000 shares of our 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.

Muller subsequently filed a Notice of Appeal from the Judgment resulting from this decision to the Second Circuit Court of Appeals in New York. The clerk of the Court recently issued an Order dismissing this appeal.

In response to the November 16, 2005 decision by the Court, Muller filed a motion seeking to set aside the Decision and Order of the Court. On March 31, 2006, the Court issued a Decision and Order denying Muller's Motion to set aside the Decision on Summary Judgment issued against Muller on November 16, 2005.

On October 27, 2006, Magistrate Judge Frank Maas, Federal District Court of the Southern District of New York, issued an order granting summary judgment in favor of the Company. The ruling provided that all shares, options and any other obligations allegedly owed by the Company to Jeffrey A. Muller, its former Chairman, were to be disgorged. The ruling also confirmed an earlier decision issued on November 16, 2005 in favor of the SEC holding Mr. Muller liable for $7.5 million in actual damages, imposing a $100,000 fine and barring 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 $9 million. Additionally, the Court further clarified that the scope of its previous disgorgement order required the disgorgement of any shares of the Company's stock that Mr. Muller or any of his nominees directly or indirectly own or control. The Company has taken action to cancel over 3.6 million shares which had been issued to the offshore companies.

The Court also confirmed the appropriateness of an action 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.

Finally, the Court ruled that Mr. Muller had no claim to an alleged $500,000 debt owed to him while the damages of over $9 million remain unpaid. The Court also ruled that other assets that were transferred by Mr. Muller to members of his family through various offshore corporations were also to be disgorged. Because the Court left unresolved an issue concerning claims against one Muller family member, the Company sought a modification of the Order. On February 8, 2007, Judge Maas issued an Amended Order which concluded that all of the STWA shares of Muller or any of his nominees directly or indirectly owned or controlled were to be recaptured by STWA and were subject to disgorgement and forfeiture. With this modification of the October 27, 2007 ruling, this order provides the complete relief requested by the Company in its motion for summary judgment.

In April 2005, Jeffrey A. Muller, the Company's former sole director and executive officer, filed a complaint against us in the Federal District Court for the Central District of California, seeking declaratory

and injunctive relief and alleging unfair competition in connection with a claimed prior patent interest in the ZEFS device and stock option rights. In seeking declaratory relief, Mr. Muller is seeking to have the patent rights in the ZEFS device that were previously transferred to us by Mr. Muller's bankruptcy trustee declared null and void.

This lawsuit brought by Mr. Muller arose out of the same claims that are the subject of ongoing litigation in the Federal District Court for the Southern District of New York, in which we have previously obtained a preliminary injunction against Mr. Muller barring him from any involvement with the Company and preventing Mr. Muller, his agents or assigns, from exercising any claimed rights to our assets or stock. Mr. Muller previously filed the same complaint in the Federal District Court for the Southern District of New York, which claim is still pending. On December 28, 2004, Federal District Court Judge George B. Daniels issued a decision dismissing motions filed by Mr. Muller against our cross-claims. The dismissal of those motions involved similar causes of action as those contained in Mr. Muller's recent lawsuit commenced in the Federal District Court for the Central District of California. Since the case in New York is still pending, we believe that the filing of the new lawsuit in California is subject to various defenses which should result in the dismissal of the new lawsuit.

On January 25, 2006, Mr. Muller's complaint, filed in the California District Court and transferred to the Federal Court in the Southern District of New York, was assigned to Judge George B. Daniels. That Complaint is currently pending, however, the issues raised in this Complaint arise from the same claims already decided by the Court in its February 8, 2007 Amended Order. The Company plans to file a request to dismiss the pending Complaint on several grounds, including that the claims sought to be litigated in this latter complaint has been included within the Summary Judgment Motions decided against Muller, his nominees and assignees. While we believe that we have valid claims and defenses, there can be no assurance that an adverse result or outcome on the pending motions or a trial of this case would not have a material adverse effect on our financial position or cash flow.

Litigation Involving Sublessor of Corporate Offices

On July 19, 2007, Scottish Glen Golf Company, Inc. doing business as KZG ("KZG") sued us in Los Angeles Superior Court, alleging unlawful detainer by us of our leased corporate offices at 5125 Lankershim Boulevard, North Hollywood, California, and failure to pay past due rent and penalties in the aggregate amount of $104,413.20. In its complaint, KZG also seeks attorney fees. Bruce H. McKinnon, the Company's former President and Chief Executive Officer, and an incumbent director, is an owner of KZG. Mr. McKinnon's wife is the President of KZG.

As disclosed in a Current Report on Form 8-K which we filed with the SEC on July 18, 2007, on July 12, 2007, KZG had presented to us a Three-Day Notice to Pay or Quit, demanding payment of unpaid rent, additional rent and penalties, in the aggregate amount of $104,413 as of such date. In addition to the unpaid rent during 2007, it was apparently KZG's position, taken for the first time, that there is a discrepancy in the calculation of base rent as far back as April 1, 2004 and that a penalty of $100 per day should be imposed continuously since January 1, 2006 under the terms of a certain provision of the 2006 Sublease.

We strongly disagree with the apparent position of KZG that there is a discrepancy in the calculation of base rent as far back as April 1, 2004 and that a penalty of $100 per day should be imposed continuously since January 1, 2006 under the terms of a certain provision of the current sublease with KZG. There may also be other aspects of KZG's positions or apparent positions with which we strongly disagree. We may also have counterclaims against KZG and its officers and directors.

We are currently reviewing the complaint and will formulate our answer to the suit. While we believe that we have valid claims and defenses, given the inherent uncertainties of litigation, we cannot predict the outcome of this matter. Accordingly, there can be no assurance that an adverse result or outcome of this matter would not have a material adverse effect on our financial position or cash flow. Please also see Part II, Item 5, "Other Information" for additional information regarding this matter.

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

In January 2007, we issued a $612,500 principal amount promissory note (for which we received $500,000 in gross and net proceeds) to Morale. In connection with this issuance, we also issued to Morale a warrant to purchase 437,500 shares of our common stock at an exercise price of $0.70 per share.

During the three-month period ended March 31, 2007, we sold $350,000 aggregate principal amount of our 2007 PIPE Notes and warrants to purchase an aggregate 750,001 shares of our common stock at $1.00 per share.

Subsequent to end of the three-month period ended March 31, 2007 and through April 27, 2007, we sold $50,000 aggregate principal amount of our 2007 PIPE Notes and warrants to purchase an aggregate 107,143 shares of our common stock at $1.00 per share.

Also subsequent to the end of the three-month period ended March 31, 2007 and through June 26, 2007, we sold $451,000 aggregate face amount of the Spring 2007 Notes, convertible into shares of our common stock at either $0.34 or $0.53 per share, and warrants to purchase an aggregate 1,815,731 shares of our common stock at $0.50 per share. Because the 2007 Spring Notes were issued at a discount to their face amount, gross and net proceeds to the Company were $410,000.

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.

Item 3. Defaults Upon Senior Securities

None

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

None

Item 5. Other Information

The Company's principal executive offices consist of leased space in North Hollywood, California. The Company subleases this space from KZ Golf, Inc. ("KZG"). Bruce H. McKinnon, the Company's former President and Chief Executive Officer, and an incumbent director, is an owner of KZG. Mr. McKinnon's wife is the President of KZG.

The Company originally entered into a sublease with KZG on October 16, 2003, which sublease expired on October 16, 2005. The Company exercised an option to renew the sublease, which renewal term was due to expire on October 15, 2007. Through October 16, 2005, the rent was $3,400 per month for approximately 1,225 square feet, and for comprehensive office support services, including reception, parking and conference facilities. During the extended lease term, the rent was $3,740 per month.

In connection with the Company's need to acquire additional office space and expanded services as its business activities were then growing, the Company entered into a new sublease dated as of January 1, 2006 with KZG (the "2006 Sublease"), replacing the original sublease and the terms applicable under the extended term thereof. The 2006 Sublease is for a term of 19 months, expiring July 31, 2007. The new rent under the 2006 Sublease is $6,208 per month for approximately 1,700 square feet of office space, and for additional common area use, expanded office support services, including a computer network, and additional parking spaces. The Company has the right to renew the 2006 Sublease for an additional term of two years at a 10% increase over the then-current rent.

Thereafter, in July 2006, the Company acquired two additional offices comprising approximately 250 square feet, and additional parking spaces, for which the Company pays KZG $964 per month in additional rent on a month-to-month basis, or a total of $7,172 per month.

Due to the Company's current cash flow difficulties, it has not been able to make most of its payments to KZG commencing January 2007. On July 12, 2007, KZG presented to the Company a Three-Day Notice to Pay or Quit, demanding payment of unpaid rent, additional rent and penalties, in the aggregate amount of $104,413 as of such date. In addition to the unpaid rent during 2007, it is apparently KZG's position, taken for the first time, that there is a discrepancy in the calculation of base rent as far back as April 1, 2004 and that a penalty of $100 per day should be imposed continuously since January 1, 2006 under the terms of a certain provision of the 2006 Sublease.

For numerous reasons, the Company strongly disagrees with the apparent position of KZG that there is a discrepancy in the calculation of base rent as far back as April 1, 2004 and that a penalty of $100 per day should be imposed continuously since January 1, 2006 under the terms of a certain provision of the 2006 Sublease. There may also be other aspects of KZG's positions or apparent positions with which the Company strongly disagrees. The Company intends to fully assess the situation, closely monitor all developments, continue discussions with KZG and take any and all such action as may be necessary or appropriate. The Company did not exercise its option to renew the 2006 Sublease. The Company is actively pursuing new office space, although alternate arrangements have not been finalized as of the date of this Report.

As previously announced in a Current Report on Form 8-K filed with the SEC on June 15, 2007 (the "Form 8-K"), on June 15, 2007, the Company and Bruce H. McKinnon agreed and entered into an agreement that Mr. McKinnon would resign as Chief Executive Officer of the Company effective on the first to occur of (i) the appointment of a new Chief Executive Officer by the Board of Directors and (ii) July 31, 2007. At the time of the filing of the Form 8-K and as stated therein, it was intended that Mr. McKinnon would continue to serve as President of the Company and would continue to receive the compensation provided for in accordance with the provisions of the employment agreement dated as of October 5, 2005 between the Company and Mr. McKinnon, through December 31, 2007, the end of the term of that agreement. Additionally, as stated in the Form 8-K, Mr. McKinnon will continue to serve as a director of the Company, until he has resigned, been removed by the stockholders or not been re-elected to the Board. The Company and Mr. McKinnon have waived any claims they may have against each other and have agreed to mutual indemnification.

On July 18, 2007, Bruce H. McKinnon was removed by the Board of Directors as President and Chief Executive Officer of the Company and its wholly-owned subsidiary, STWA Asia, effective immediately. Mr. McKinnon also was removed by the Board of Directors as a director of STWA Asia, effective immediately. Mr. McKinnon will continue to serve as a director of the Company, until he has resigned, been removed by the stockholders or not been re-elected to the Board.

Also on July 18, 2007, the Board of Directors of the Company appointed Charles Blum as President and Chief Executive Officer of the Company. Mr. Blum will assume his positions within the next several days. Mr. Blum was also appointed to the Board of Directors to fill the vacancy created by the resignation on June 5, 2007 of Maj. Gen. Dennis M. Kenneally (Ret.), such appointment to take effect upon Mr. Blum's joining the Company as President and Chief Executive Officer. Since retiring from his previous position in July 2002, Mr. Blum, age 69, served as a business consultant. From July 1980 to July 2002, Mr. Blum served as President of the Specialty Equipment Market Association (SEMA).

Effective July 18, 2007, the Company entered into an employment agreement with Mr. Blum (the "Blum Employment Agreement"), pursuant to which Mr. Blum will serve as the Company's President and Chief Executive Officer, commencing on a mutually agreed date but not later than August 1, 2007. Pursuant to the Blum Employment Agreement, Mr. Blum's employment is for a one-year term, subject to automatic one-year extensions and provides for annual base compensation of $200,000 per year, subject to periodic review and adjustment. In addition, Mr. Blum will receive an automobile allowance of $900 per month and four weeks of paid vacation annually. Mr. Blum is entitled to participate in all employee benefit plans that the Company makes available to its employees generally; provided that if Mr. Blum elects not to participate in the Company's group medical insurance plan, he will be reimbursed in an amount equal to the lesser of (i) the premium the Company would have paid to include him as a participant in that group health insurance plan and (ii) the sums paid by him in connection with maintaining his private health insurance. The Company will also reimburse Mr. Blum the reasonable costs paid by him for maintaining DSL Internet access and other direct costs of maintaining an office at his home, but only until such time as the Company shall provide him with an office at a location reasonably acceptable to him.

Mr. Blum is eligible to receive stock option grants under the Company's stock option plan and will receive an initial grant of options to purchase a number of shares of the Company's common stock equal to the result of 100,000 divided by the closing price of a share of the Company's common stock (the "Closing Price") on the date Mr. Blum assumes his position as Chief Executive Officer and President of the Company (the "Effective Date"). The options will vest on the first anniversary of the Effective Date and will be exercisable at the Closing Price for 10 years from the Effective Date.

Additionally, on the first anniversary of the Effective Date, Mr. Blum is eligible to receive a stock option grant under the Company's stock option plan to purchase a number of shares of the Company's common stock equal to the result of 100,000 divided by the Closing Price on the first anniversary of the Effective Date. These options will vest on the second anniversary of the Effective Date and will be exercisable at the Closing Price on the first anniversary of the Effective Date for 10 years from the date of grant.

Mr. Blum is eligible to receive an annual cash bonus in an amount equal to 2% of the Company's net profit, if any, for its most recently completed fiscal year, computed in accordance with generally accepted accounting principles applied consistently with prior periods. The bonus shall be payable, if at all, on the anniversary date of employment of each year of the term if Mr. Blum continues to be employed by the Company on the relevant payment date.

The Blum Employment Agreement also contains terms and conditions customary in agreements of this kind, including provisions relating to protection of the Company's intellectual property, non-disclosure and non-solicitation. The Blum Employment Agreement also provides, among other things, that if Mr. Blum's employment should terminate by reason of a change of control of the Company he is entitled to continue to receive compensation and participate in the Company's employee benefit plans for a period of 12 months following such termination.

The Board of Directors has determined that Mr. Blum is not independent as a director under the standards currently in effect of the Nasdaq Stock Market and he will not serve on any standing committees of the Board of Directors. A description of the transactions, if any, during the past two years to which the Company was or is to be a party and in which Mr. Blum had or is to have a material interest is not presently available, but based on information currently available to the Company and based further on information received from Mr. Blum, the Company currently believes that no such transactions exist.

As an interim matter, on July 18, 2007, the Board of Directors appointed incumbent director and former President and Chief Executive Officer Eugene E. Eichler as Acting President and Acting Chief Executive Officer of the Company. Mr. Eichler will serve in these capacities, without compensation, through July 24, 2007. Mr. Blum will assume his positions as President and Chief Executive Officer on July 25, 2007.

Mr. Eichler's biographical information has previously been provided, most recently on pages 34-35 of the prospectus dated October 30, 2006, which was filed with the SEC on November 1, 2006. Additionally, the details of Mr. Eichler's earlier separation and the terms of his separation agreement, including compensation, were disclosed under (i) Part II, Item 5, "Other Information", of the Company's Quarterly Report on Form 10-QSB for the period ended September 30, 2006, at pages 46-47, which was filed with the SEC on November 14, 2006; and (ii) Item 5.02(b), "Departure of Directors or Principal Officers; Election of Directors; Appointment of Principal Officers", of the Company's Current Report on Form 8-K, which was filed with the SEC on January 12, 2007. A description of other transactions

during the past two years to which the Company was or is to be a party and in which Mr. Eichler had or is to have a material interest have been disclosed from time to time in the reports and other filings that the Company makes with the SEC. Mr. Eichler does not currently serve on any standing committees of the Board of Directors.

On July 19, 2007, KZG sued us in Los Angeles Superior Court, alleging unlawful detainer by us of our leased corporate offices at 5125 Lankershim Boulevard, North Hollywood, California, and failure to pay past due rent and penalties in the aggregate amount of $104,413.20. See Part II, Item 1, “Legal Proceedings — Litigation Involving Sublessor of Corporate Offices”.

Item 6. Exhibits

Exhibit No.	Description
10.1†	Separation Agreement and General Mutual Release of Claims dated as of June 15, 2007 between the Company and Bruce H. McKinnon
10.2†	Employment Agreement dated as of July 18, 2007 between the Company and Charles Blum
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)
†	Management contract or compensatory plan or arrangement.

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: July 24, 2007

By: /s/ CHARLES K. DARGAN II
Charles K. Dargan II
Chief Financial Officer

EXHIBIT INDEX

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Exhibit 10.1

SEPARATION AGREEMENT AND
GENERAL MUTUAL RELEASE OF CLAIMS

This Separation Agreement and General Mutual Release of Claims dated as of June 15, 2007 (this "Agreement") is made between Save the World Air, Inc. (the "Company") and Bruce H. McKinnon, an individual ("McKinnon"). The Company and McKinnon are sometimes referred to collectively herein as the "Parties".

WHEREAS, McKinnon wishes to resign as Chief Executive Officer ("CEO") of the Company, for personal reasons; and

WHEREAS, the Company wishes to accept the resignation of McKinnon as CEO of the Company; and

WHEREAS, the Parties wish to provide for clarity, finality and certainty as to the basis for McKinnon's resignation, and the terms of cash and non-cash compensation to which McKinnon is entitled following such resignation; and

WHEREAS, McKinnon wants to release any and all claims that he may have or which exist, or may exist, by him against the Company, known and unknown, including but not necessarily limited to, all known and unknown claims arising out of McKinnon's service to the Company as CEO of the Company or any subsidiary thereof (individually, a "Subsidiary" and collectively the "Subsidiaries") except as specifically provided for herein; and

WHEREAS, the Company wants to release any and all claims that it may have or which exist, or may exist, by it against McKinnon, known and unknown, including, but not necessarily limited to, all known and unknown claims arising out of McKinnon's service to the Company as CEO of the Company or any Subsidiary thereof, except as specifically provided for herein;

THEREFORE, in consideration of the promises in this Agreement, the adequacy of which is acknowledged, the Parties agree as follows:

1. Resignation

1.1 Resignation as CEO. McKinnon hereby tenders his resignation as Chief Executive Officer of the Company and each Subsidiary under that certain Employment Agreement dated October 5, 2005 between the Company and McKinnon (the "Employment Agreement"), such resignations to take effect upon the appointment by the Board of Directors of the Company (the "Board") of his successor, but in no event later than July 31,2007.

1.2 Resignation from Other Offices. McKinnon hereby tenders his resignation from any and all other offices he holds with the Company and each Subsidiary, other than the office of President of the Company, such resignations to take effect upon the appointment by the Board of his successor, but in no event later than July 31, 2007. Mr. McKinnon is not tendering his resignation as President of the Company and shall continue to serve as President of the Company, with all the rights, privileges, prerogatives

and responsibilities attendant thereto, including without limitation, compensation therefor, until he has resigned, been removed by the Board or the Employment Agreement has terminated.

1.3 Resignation as Director. McKinnon hereby tenders his resignation as a director of each Subsidiary effective July 31, 2007. McKinnon is not tendering his resignation as a director of the Company and shall continue to serve as a director of the Company with all the rights, privileges, prerogatives and responsibilities attendant thereto, including without limitation, compensation therefore.

2. Compensation

2.1 No Reduction in Salary. Notwithstanding the provisions of Section 1 above, each component of McKinnon's compensation under the Employment Agreement shall remain unchanged for the period commencing the date hereof and continuing thereafter to and including December 31, 2007 (the "Remaining Term"), which period constitutes the remaining term of the Employment Agreement, all such amounts to be paid in accordance with the Company's normal pay policies applicable to senior officers of the Company; provided, however, that the Company may not declare a moratorium on any payment hereunder to McKinnon as part of cash management by the Company, or any other reason, without McKinnon's prior written consent. All compensation under the Employment Agreement that has been accrued but is, as of the date of this Agreement unpaid, as well as all subsequent payments that may become accrued and not paid, shall be paid to McKinnon as soon as reasonably practicable, taking into account the Company's available cash and other operating requirements, but in no event shall such sums be paid later than the first to occur of (i) the consummation of a financing transaction in which at least $2,000,000. gross proceeds are received by the Company and (ii) August 31, 2007 All sums paid hereunder shall be subject to appropriate withholding as required by applicable laws and regulations.

2.2 Compensation. Pursuant to the Employment Agreement, McKinnon shall remain eligible for and be entitled to any additional amounts, in the form of cash or non-cash compensation, as the Compensation Committee of the Board, or the Board, may determine, in their sole and absolute discretion, or nothing as the Compensation Committee of the Board or the Board may determine.

2.3 Other Benefits. McKinnon shall be entitled to all other benefits not expressly provided for herein, pursuant to the Employment Agreement for the Remaining Term.

3. Claims

3.1 Waiver of Claims. McKinnon acknowledges that the consideration provided for pursuant to Section 2 of this Agreement is provided to him in full and complete satisfaction and discharge of any and all claims that he may have against the Company, its parents, subsidiaries, directors, officers and agents, whether asserted or

unasserted, known or unknown, occurring up to and including the date of execution of this Agreement. The Company acknowledges that McKinnon's agreements and releases set forth in this Agreement are provided to the Company in full and complete satisfaction and discharge of any and all claims that the Company, its parents, subsidiaries, directors, officers and agents may have against McKinnon, whether asserted or unasserted, known or unknown, occurring up to and including the date of execution of this Agreement.

3.2 Section 1542. With respect to the waivers set forth in Section 3.1 above, the Parties and each of them acknowledges and expressly waives any and all rights he or it may have under California Civil Code Section 1542 which provides as follows:

> A general release does not extend to claims which the creditor does not know or suspect to exist in his favor at the time of executing the release, which if known to him must have materially affected his settlement with the debtor.

3.3 No Other Relief. Each of the Parties understands and agrees that all other entities released herein shall neither make nor cause to be made any additional relief to the other Party, except as specifically referenced herein. Should any third party, including any state or federal agency, bring any action or claim against the Company on McKinnon's behalf, either collectively or individually, McKinnon acknowledges and agrees that this Agreement provides him with full relief and that he will not request any other relief. Should any third party, including any state or federal agency, bring any action or claim against McKinnon on the Company's behalf, either collectively or individually, the Company acknowledges and agrees that this Agreement provides it with full relief and that it will not request any other relief.

3.4 Indemnification by the Company. The Company agrees to indemnify and hold McKinnon harmless from any "Damages" (as defined in Section 3.7 below) which McKinnon suffers as a result of the agreements made in the Employment Agreement, this Agreement or anything else arising from, or in connection with, McKinnon's service as an employee of the Company.

3.5 Indemnification by McKinnon. McKinnon agrees to indemnify and hold the Company harmless from any Damages which the Company suffers as a result of the agreements made in the Employment Agreement, this Agreement or anything else arising from, or in connection with, McKinnon's service as an employee of the Company.

3.6 3.6 Statutory Indemnification. Notwithstanding anything to the contrary contained in Sections 3.4 or 3.5 of this Agreement, McKinnon shall be entitled to indemnification in accordance with laws of the state of Nevada, and the Articles of Incorporation and Bylaws of the Company, to the fullest extent provided by law.

3.7 Definitions. As used in this Section 3, the term "Damages" shall mean (i) the amount of any damages awarded against the Company in a judgment entered by any court of competent jurisdiction pursuant to which judgment a finding has been made, (ii) all amounts paid in settlement of any "Third Party Claim" (as defined below) and (iii) all legal fees and related costs incurred in connection with defending any Third Party Claim. As used in this Section 3, the term "Third Party Claim" shall mean any claim

asserted by any person other than McKinnon and the Company, and shall also include claims asserted in the name of the Company in the nature of a derivative claim.

4. Miscellaneous

4.1 Nondisclosure. The Parties hereto agree to keep the terms of this Agreement and the transactions provided for herein strictly confidential, except as the same may be required to be disclosed under the Rules and Regulations of the United State Securities and Exchange Commission. No press release or other public statements shall be issued or made by either Party without the prior written consent of the other Party. The Parties further agree not to disparage each to any third person(s), either orally or in writing. The Parties acknowledge that irreparable harm would occur to the non-breaching Party if the other Party violates the terms of this paragraph 4, and, accordingly, the non-breaching Party may immediately seek legal and equitable relief, including without limitation injunctive relief, against the Party who breaches any provision of this paragraph 4.

4.2 Severability. If any portion of this Agreement is void or deemed unenforceable for any reason, the unenforceable portion shall be deemed severed from the remaining portions of this Agreement, which shall otherwise remain in full force.

4.3 Disputes: Applicable Law. Any dispute under this Agreement shall be resolved by meditation and, if such meditation is not successful, by arbitration pursuant to the rules of the Los Angeles Superior Court. This Agreement shall be interpreted in accordance with California law without regard to conflict of laws principles.

4.4 Counterparts. This Agreement may be executed in two or more counterparts, each of which will be deemed an original, but all of which together shall constitute one and the same instrument. Faxed copies shall be effective and enforceable.

4.5 Authorization. Each of the Parties and each of the individuals signing this Agreement on behalf of the Parties represents and warrants that the individuals executing this Agreement on behalf of the Parties have the capacity and have been duly authorized to execute this Agreement on behalf of the party so indicated. Each of the Parties shall indemnify the other parties to this Agreement, and hold the other harmless, for, from and against any and all damages, costs, attorneys' fees, and other expenses, if the respective signatory executing on behalf of such party is not so authorized.

4.6 Conflicts. In the event of any conflict between the provisions of the Employment Agreement and this Agreement, the provisions of this Agreement shall govern.

[remainder of this page intentionally left blank]

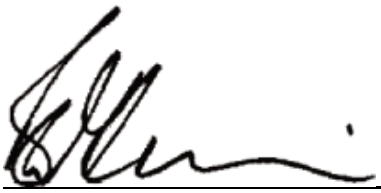
4.7 Entire Agreement. This Agreement constitutes the entire agreement of the Parties and that in executing this Agreement neither Party has relied upon any representation or statement not set forth herein with regard to the subject matter, basis, or effect of this Agreement. McKinnon represents that he has been given adequate time to consider this Agreement before executing it and that he executes this Agreement as his own free act and deed.

WHEREFORE, the Parties, by their signatures below, acknowledge that there exist no other promises, representations, or agreements relating to this Agreement, except as specifically set forth herein and that they voluntarily enter into this Agreement with the intent to be legally bound thereby, as of the date first above written.

SAVE THE WORLD AIR, INC.
("Company")

By _____
Name: Joseph Helleis
Title: Chairman of the Board

("McKinnon")



_____
Bruce H. McKinnon

Exhibit 10.2

EMPLOYMENT AGREEMENT

THIS EMPLOYMENT AGREEMENT (this "**Agreement**") is entered into as of July 18, 2007, by and between Save the World Air, Inc, a Nevada corporation (the "Company"), whose address is 5125 Lankershim Boulevard, North Hollywood, California 91601, and Charles Blum ("**Executive**"), an individual, whose address is 1505 Upland Hills Drive North, Upland, California 91784, with reference to the following:

RECITALS

A. Executive has certain technical knowledge, skills and abilities pertaining to the business in which the Company engages.

B. The Company wishes to employ Executive as its President and Chief Executive Officer, and Executive wishes to accept employment with the Company, all on the terms and subject to the conditions set forth in this Agreement.

AGREEMENT

Accordingly, the parties agree as follows:

1. **EFFECTIVE DATE AND TERM**. Unless sooner terminated as provided in this Agreement, including as a result of the Company's early termination of this Agreement as provided in Section 4 below, the Company shall employ Executive for an initial term commencing on a date to be agreed between the parties but not later than August 1, 2007 (the "**Effective Date**") and continuing thereafter until the close of business on the day immediately preceding the first anniversary of the Effective Date. Thereafter, this Agreement shall be renewed for successive one year periods unless either party shall give written notice to the other, not later than April 30 of the then-current year of the Term that this Agreement shall not be renewed (the "Expiration Date"). This Agreement shall in all respects terminate on the Expiration Date, except for those obligations of either party that are expressly stated to continue after such time or by nature will continue after such time. The period beginning on the Effective Date and ending on the earlier of the Expiration Date or the date Executive's employment under this Agreement actually terminates is referred to as the "Term."

2. **POSITION AND DUTIES**.

2.1 **General Duties**. Executive shall serve as the Company's President and Chief Executive Officer, and in such capacity shall be one of the Company's senior executive officers. Executive's duties shall be consistent with such position. In carrying out his duties, Executive shall use Executive's best efforts, skills, judgment and abilities, and shall at all times promote the Company's interests and perform and discharge well and faithfully, those duties. Executive shall report directly to the Company's Board of Directors. In acting on the Company's behalf, Executive shall observe and be governed by all of the Company's rules and policies, In addition, Executive shall abide by all of the requirements of the Securities and Exchange Commission, and adhere to the policies and requests of the Company with respect thereto, as the same may exist from time to time, applicable to executive officers of public companies.

2.2 **Full-Time Employment**. At all times during the Term, Executive shall devote Executive's entire business time, attention and energies to the Company's business, and shall furnish services for the Company and for its subsidiaries, affiliates and divisions. During the Term, Executive shall not engage in any activity that would materially interfere with or adversely affect Executive's performance of Executive's duties under this Agreement or which could reasonably be expected to be competitive with or adverse to the business of the Company or any of its subsidiaries, affiliates or divisions.

2.3 **Place of Performance**. In connection with Executive's employment under this Agreement, Executive shall be based at the Company's offices where the same are from time to time located during the term of this Agreement, and which are, on the date hereof, in North Hollywood, California.

3. **COMPENSATION**.

3.1 "**Compensation**". "**Compensation**" means the Base Salary (as defined below) and bonus, if any, pursuant to this Section 3.

3.2 **Base Salary**. For all services rendered pursuant to this Agreement to the Company and any of its subsidiaries and affiliates, commencing on the Effective Date Executive shall receive a base salary (as may be adjusted from time to time, the "**Base Salary**") of $200,000 per year. On or prior to each anniversary of the Effective Date, the Company's Board of Directors, or the appropriate committee thereof, shall review the performance of the Executive hereunder and shall consider whether or not to alter the Base Salary; provided that the Base Salary shall not be reduced unless such reduction is in proportion to, and on all of the other terms and conditions promulgated in connection with, a reduction in salaries paid to other senior executives of the Company generally.

3.3 **Bonus**. Executive shall be eligible to receive an annual cash bonus in an amount equal to 2% of the Company's net profit, if any, for its most recently completed fiscal year, computed in accordance with generally accepted accounting principles applied consistently with prior periods. The bonus shall be payable, if at all, on the anniversary date of employment of each year of the term; provided that no bonus shall be payable if the Executive is not, on such payment date, in the employ of the Company.

3.4 **Benefits**. Executive shall be eligible to receive employee benefits during the Term, at such times and on such terms and conditions as such benefits are made available to the senior employees of the Company generally. In addition, Executive shall receive paid vacation of four weeks per year. Executive shall be entitled to participate in the Company's stock option plan as determined by the Compensation Committee of the Board of Directors (the "Compensation Committee") in its sole, full and absolute discretion, such participation to be in addition to the stock option grant provided for pursuant to Section 3.7 below. The Company shall provide to the Executive an unaccountable monthly automobile allowance of $900.00, which amount shall be payable on the last day of each month during the Term. Notwithstanding the provisions of the first sentence of this Section 3.4, the Executive may elect not to participate in any group health insurance plan which may be offered to employees of the Company. If the

Executive elects not to participate in such group health insurance plan, the Executive shall be paid on the last day of each month during the Term the lesser of (i) the premium the Company would have paid to include the Executive as a participant in the Company's group health insurance plan and (ii) the sums paid by the Executive in connection with maintaining private health insurance for the Executive.

3.5 **Expenses**. The Company shall reimburse Executive for all reasonable and ordinary expenses determined in the Company's sole discretion that Executive incurs or pays during the Term in performing Executive's services under this Agreement. Ordinary expenses reimbursable to the Executive pursuant to this Section 3.5 shall include the reasonable costs paid by the Executive for maintaining dsl Internet access and other direct costs of maintaining an office at the home of the Executive, but only until such time as the Company shall provide to the Executive an office at a location reasonably acceptable to the Executive. The Company shall, however, be required to make any such reimbursement only after Executive presents appropriate written expense statements, vouchers or such other supporting information in accordance with the Company's reimbursement policies, as the Company may adopt from time to time. The Company shall notify Executive of any dispute with respect to any such expenses within three months of any request for reimbursement or the expense shall be classified as non-recoverable. Reimbursements shall be in arrears unless other arrangements are made in advance.

3.6 **Payment of Compensation**. All Compensation and other amounts payable to Executive under this Agreement, whether for a period during or after the Term, shall be paid in such installments and on such schedule as the Company may from time to time implement for general payroll purposes, provided that the Base Salary shall be paid at least monthly. Any Base Salary required to be paid to Executive upon a termination of Executive's employment in excess of amounts accrued through the Date of Termination (as defined in Section 4.1.1 below) shall be paid in the same manner that Base Salary is paid during the Term, but not more than 30 days from the Date of Termination. Any payments made by the Company shall be designated by the Company as applied towards base compensation, bonus payment or other remuneration as the case may be. Any payments made prior to the effective date of this Agreement shall not be applied to any calculations called for in this Agreement.

3.7 **Stock Option Grant**. Subject to the final decision of the Compensation Committee and on terms and subject to conditions provided for by the Company's then-current Stock Option Plan, the Company will use its reasonable efforts to cause to be granted to Executive:

(i) an option (the "Initial Option") to purchase a number of shares (the "Initial Option Shares") of the Company's common stock equal to the result of (A) 100,000 divided by (B) the closing bid price per share of the Company's Common Stock on the Effective Date. The Initial Option shall be an incentive stock option, shall be exercisable at the closing price per share on the Effective Date, shall be exercisable for ten years from the date of grant and shall vest on the first anniversary of the Effective Date; and

(ii) an option (the "Supplemental Option") to purchase a number of shares (the "Supplemental Option Shares") of the Company's common stock equal to the result of (A) 100,000 divided by (B) the closing price per share of the Company's Common Stock first anniversary of the Effective Date. The Supplemental Option shall be an incentive stock option, shall be exercisable at the closing price per share on the first anniversary of the Effective Date, shall be exercisable for ten years from the date of grant and shall vest on the second anniversary of the Effective Date.

Consistent with the foregoing, the precise terms and conditions of the agreements evidencing the Initial Option and the Supplemental Option (each, a "Stock Option Agreement") to be entered into between the Company and the Executive shall be as determined by the Board of Directors and/or the Compensation Committee. Each Stock Option Agreement and each stock certificate evidencing any Initial Option Shares or any Supplemental Option Shares shall bear a legend substantially in the following form:

> THESE SECURITIES HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, OR QUALIFIED FOR SALE UNDER ANY STATE SECURITIES LAWS (COLLECTIVELY, "SECURITIES LAWS") AND MAY NOT BE OFFERED, SOLD, PLEDGED, HYPOTHECATED OR OTHERWISE TRANSFERRED UNLESS REGISTERED OR QUALIFIED FOR SALE UNDER ALL APPLICABLE SECURITIES LAWS OR UNLESS, IN THE OPINION OF COUNSEL SATISFACTORY TO THE ISSUER, IN FORM AND SUBSTANCE SATISFACTORY TO THE ISSUER, ANY SUCH OFFER, SALE OR OTHER TRANSFER IS EXEMPT FROM THE REGISTRATION OR QUALIFICATION REQUIREMENTS OF SUCH SECURITIES LAWS.

4. **TERMINATION AND COMPENSATION UPON TERMINATION**.

4.1 **Definitions**.

4.1.1 "**Date of Termination**" has the following meaning: (a) in the case of a termination of Executive's employment pursuant to this Agreement due to Executive's death or Disability (as defined below), the date Executive dies or the date on which it is determined that Executive has suffered a Disability, as applicable; and (b) in the case of any other termination of Executive's employment pursuant to this Agreement, the date specified for termination of Executive's employment in the Notice of Termination (as defined below), provided that the date specified shall be no earlier than the time the Notice of Termination is delivered.

4.1.2 "**Notice of Termination**" means a written document delivered by the party terminating this Agreement to the other party that specifies (i) the section of this Agreement pursuant to which termination is being made and (ii) (the Date of Termination.

4.2 **Effectiveness of Termination**. Termination of Executive's employment, for any reason, shall be effective upon the Date of Termination.

4.3 **Death**. Upon Executive's death, this Agreement shall automatically forever terminate.

4.4 **Disability**. The Company may, acting in its sole and absolute discretion, terminate Executive's employment under this Agreement because of Executive's Disability by delivering to Executive of a Notice of Termination, which termination shall be effective 30 days after delivery of such Notice of Termination. For purposes of this Agreement, "**Disability**" means Executive's physical or mental incapacity or illness rendering Executive unable to perform Executive's duties under this Agreement on a long-term basis (i) as evidenced by Executive's failure or inability to perform Executive's duties under this Agreement for a total of 90 days in any 360 day period, or (ii) as determined by an independent and licensed physician whom the Company selects, or (iii) as determined without recourse by the Company's disability insurance carrier, if any.

4.5 **Termination by Company Without Cause**. The Company may, acting in its sole and absolute discretion, at any time terminate Executive's employment under this Agreement, upon no notice without Cause (as defined below), or for any reason whatsoever or for no reason, by delivering to Executive a Notice of Termination.

4.6 **Termination for Cause**. The Company may at any time terminate Executive's employment for Cause by delivering to Executive a Notice of Termination. For purposes of this Agreement, "**Cause**" means that the Company, reasonably and in good faith, forms the belief that Executive has (i) committed any act or omission constituting a material breach of this Agreement; (ii) engaged in gross negligence or willful misconduct in connection with the Company's business; (iii) been convicted of, or plead guilty or *nolo contendre* in connection with, fraud or any crime that constitutes a felony or that involves moral turpitude or theft; or (iv) undertaken any act injurious to the Company's business, including insubordination or failure to follow a directive of any of Executive's superiors.

4.7 **Voluntary Termination**. Executive may terminate Executive's employment with the Company at any time, for any reason whatsoever, by giving the Company a Notice of Termination, which termination shall be effective on the sooner of (i) 30 days after delivery of such Notice of Termination or (ii) the Company's notice to the Executive that it has accepted the Notice of Termination delivered by the Executive.

4.8 **Involuntary Termination**. The Company may terminate this Agreement in conjunction with a Change of Control, merger, acquisition, bankruptcy or dissolution of the Company. The Company shall pay Executive the amounts provided for in Section 4.9 below upon any termination pursuant to this Section 4.8. For purposes of this Agreement, "Change of Control" means the occurrence of one or more of the following events:

(i) the consummation of a merger or consolidation of the Company with or into another entity or any other corporate reorganization, if more than fifty percent (50%) of the combined voting power of the continuing or surviving entity's securities outstanding immediately after such merger, consolidation or other reorganization is owned by persons who were not stockholders of the Company immediately prior to such merger, consolidation or other reorganization; or

(ii) the sale, transfer or other disposition of all or substantially all of the Company's assets.

4.9 **Payment Upon Termination**. If Executive's employment under this Agreement is terminated by the Company pursuant to Section 4.8, Executive shall be entitled to receive (i) all Compensation that has accrued through the Date of Termination, plus (ii) a severance payment equal to one year's Compensation, plus the Executive shall be entitled to continue to participate in the Company's employee benefit programs offered to other senior management employees of the Company for a period of 12 months following the Date of Termination; provided, however, that if at any time while the Company is required to pay severance to Executive pursuant to clause (ii) of this paragraph any event occurs that would cause the termination of Executive's employment (for example, Executive dies) or give rise to the right of the Company to terminate this Agreement for Cause or due to Executive's Disability were Executive still employed pursuant to this Agreement, then the Company's obligation to pay such severance shall thereupon immediately terminate. If Executive's employment under this Agreement is terminated for any other reason except for termination pursuant to Section 4.8, Executive (or in the case of Executive's death, Executive's estate or other legal representative) shall only be entitled to receive the Compensation accrued through the Date of Termination.

4.10 **Effect of Termination**. The amounts payable to Executive pursuant to Section 4.9 upon a termination of Executive's employment shall upon payment constitute full and complete satisfaction of the Company's obligations to Executive in connection with this Agreement and the Company's employment of Executive. Executive shall have no further rights or remedies with respect to or against the Company in connection with this Agreement or the Company's employment of Executive. Notwithstanding anything to the contrary in this Agreement, Executive's representations, warranties, covenants, duties and other obligations set forth under Sections 5, 6, 7, 10 and 11 of this Agreement shall survive and continue after any termination of this Agreement, regardless of the reason for the termination.

5. **WORK MADE FOR HIRE**

5.1 **Assignment.** Executive and/or designates of the Executive shall promptly and fully inform the Company of, and disclose to the Company, any and all ideas, processes, trademarks, trade names, service marks, service mark applications, copyrights, mask work rights, fictitious business names, technology, patents, know-how, trade secrets, computer programs, original works of authorship, formulae, concepts, themes, inventions, designs, creations, new works, derivative works and discoveries, and all applications, improvements, rights and claims related to any the foregoing, and all other intellectual property, proprietary rights and work product, whether or not patentable or copyrightable, registered or unregistered or domestic or foreign, and whether or not relating to a published work, that Executive develops, makes, creates, conceives or reduces to practice during the Term, whether alone or in collaboration with others (collectively, "Invention Ideas"). Executive hereby assigns to the Company exclusively in perpetuity throughout the world all right, title and interest (choate or inchoate) in (i) the Invention Ideas, (ii) all precursors, portions and work in progress with respect thereto and all inventions, works of authorship, mask works, technology, information, know-how, materials and tools relating thereto or to the development, support or maintenance thereof

and (iii) all copyrights, patent rights, trade secret rights, trademark rights, mask works rights, *sui generis* database rights and all other intellectual and industrial property rights of any sort and all business, contract rights, causes of action, and goodwill in, incorporated or embodied in, used to develop, or related to any of the foregoing (collectively "Intellectual Property"). All copyrightable Invention Ideas are intended by Executive to be a "work-made-for-hire" by Executive for the Company and owned by the Company pursuant to Section 201 (b) of Title 17 of the United States Code. Executive shall do and perform, or cause to be done and performed, all such further acts and things, and shall execute and deliver all such other agreements, certificates, instruments and documents, as the Company may reasonably request in order to obtain patent or copyright registration on all Invention Ideas and Intellectual Property, and shall execute and deliver all documents, instruments and agreements, including the formal execution of an assignment of copyright and/or patent application or issued patent, and do all things necessary or requested by the Company, in order to enable the Company to ultimately and finally obtain and enforce full and exclusive title to all Invention Ideas and Intellectual Property and all rights assigned pursuant to this Section 5. Executive hereby appoints the Company as Executive's irrevocable attorney-in-fact for the purpose of executing and delivering all such documents, instruments and agreements, and performing all such acts, with the same legal force and effect as if executed and delivered and taken by Executive.

5.2 **License.** If for any reason the foregoing assignment is determined to be unenforceable Executive grants to the Company a perpetual, irrevocable, worldwide, royalty-free, exclusive, sub-licensable right and license to exploit and exercise all such Invention Ideas and Intellectual Property.

5.3 **Presumptions.** Because of the difficulty of establishing when Executive first conceives of or develops Intellectual Property, proprietary rights or work product or whether such Intellectual Property, proprietary rights or work product results from access to the Company's confidential and proprietary information or equipment, facilities or data, Executive agrees that any Intellectual Property, proprietary rights and work product shall be presumed to be an Invention Idea if it is conceived, developed, used, sold, exploited or reduced to practice by Executive or with the aid of Executive within one year after the normal termination of Executive's employment with the Company. Executive can rebut that presumption if Executive proves that the intellectual property, proprietary rights and work product (i) was first conceived or developed after termination of Executive's employment with and by the Company; (ii) was conceived or developed entirely on Executive's own time without using the Company's equipment, supplies, facilities or confidential and proprietary information; and (iii) did not result from any work performed by Executive for or on behalf of the Company.

5.4 **Exclusions.** Executive acknowledges that there is no intellectual property, proprietary right or work product that Executive desires not to be deemed Invention Ideas or Intellectual Property and thus to exclude from the above provisions of this Agreement. To the best of Executive's knowledge, there is no other existing contract in conflict with this Agreement or any other contract to assign ideas, processes, trademarks, service marks, inventions, technology, computer programs, original works of authorship, designs,

formulas, discoveries, patents or copyrights that is now in existence between Executive and any other person or entity.

5.5 **Labor Code.** This Section 5 shall not operate to require Executive to assign to the Company any of Executive's rights to inventions, intellectual properties or work products that would not be assignable under the provisions of California Labor Code Section 2870. Executive represents and warrants to the Company that this paragraph constitutes the Company's written notification to Executive of the provisions of Section 2870 of the California Labor Code, and Executive represents and warrants to the Company that Executive has reviewed Section 2870 of the California Labor Code.

6. **UNFAIR COMPETITION AND PROTECTION OF PROPRIETARY INFORMATION**.

6.1 **Proprietary Information.** Executive shall not at any time (including after Executive's employment with the Company terminates) divulge, furnish or make accessible to anyone any of the Company's Proprietary Information, or use in any way any of the Company's Proprietary Information other than as reasonably required to perform Executive's duties under this Agreement. Executive shall not undertake any other acts or omissions that would reduce the value to the Company of the Company's Proprietary Information. The restrictions on Executive's use of the Company's Proprietary Information shall not apply to knowledge or information that Executive can prove is part of the public domain through no fault of Executive. Executive agrees that such restrictions are fair and reasonable.

6.2 **Injunctive Relief.** Executive agrees that the Company's Proprietary Information constitutes a unique and valuable asset of the Company that the Company acquired at great time and expense, and which is secret and confidential and will only be available to or communicated to Executive in confidence in the course of Executive's provision of services to the Company. Executive also agrees that any disclosure or other use of the Company's Proprietary Information other than for the Company's sole benefit would be wrongful, would constitute unfair competition and will cause irreparable and incalculable harm to the Company and to its subsidiaries, affiliates and divisions. In addition to all other remedies the Company may have, it shall have the right to seek and obtain appropriate injunctive and other equitable relief, including emergency relief, to prevent any violations of this Section 6.

6.3 **Non-Solicitation.** Executive agrees that the Company's employees constitute a valuable asset of the Company. Executive agrees that Executive shall not, during the Term and for a period of two years thereafter, directly or indirectly, for Executive or on behalf of any other person or entity, solicit any person who was an employee of or consultant to the Company (at any time while Executive is performing any services for the Company, or at any time within twelve months prior to or after such solicitation) for a competing business or otherwise induce or attempt to induce any such persons to terminate their employment or relationship with the Company or otherwise to disrupt or interfere, or attempt to disrupt or interfere, with the Company's employment or relationships with such persons. Executive agrees that any such solicitation, inducement or interference would be wrongful and would constitute unfair competition, and will

cause irreparable and incalculable harm to the Company. Further, Executive shall not engage in any other unfair competition with the Company. Executive agrees that such restrictions are fair and reasonable.

6.4 **Privacy.** Executive recognizes and agrees that Executive has no expectation of privacy with respect to Company's telecommunications, networking or information processing systems (including stored computer files, e-mail messages and voice messages), and that Executive's activity, and any files or messages, on or using any of those systems may be monitored at any time without notice.

6.5 **Definition.** As used in this Agreement, "Company's Proprietary Information" means any knowledge, trade secrets (including "trade secrets" as defined in Section 3426.1 of the California Civil Code), Invention Ideas, proprietary rights or proprietary information, intangible assets or property, and other intellectual property (whether or not copyrighted or copyrightable or patented or patentable), information and materials (including processes, trademarks, trade names, service marks, service mark applications, copyrights, mask work rights, technology, patents, patent applications and works of authorship), in whatever form, including electronic form, and all goodwill relating or appurtenant thereto, owned or licensed by the Company or any of its subsidiaries, affiliates or divisions, or directly or indirectly useful in any aspect of the business of the Company or its subsidiaries, affiliates or divisions, whether or not marked as confidential or proprietary and whether developed by Executive, by the Company or its subsidiaries, affiliates or divisions or by others. Without limiting the foregoing, the Company's Proprietary Information includes (a) the names, locations, practices and requirements of any of the Company's customers, prospective customers, vendors, suppliers and personnel and any other persons having a business relationship with the Company; (b) confidential or secret development or research work of the Company or its subsidiaries, affiliates or divisions, including information concerning any future or proposed services or products; (c) the Company's accounting, cost, revenue and other financial records and documents and the contents thereof; (d) the Company's documents, contracts, agreements, correspondence and other similar business records; (e) confidential or secret designs, software code, know how, processes, formulae, plans and devices; and (f) any other confidential or secret aspect of the business of the Company or its subsidiaries, affiliates or divisions.

7. **RESTRICTION OF EXECUTIVE'S ACTIVITIES**. During the Term, including any period during which the Company is making any payments to Executive pursuant to this Agreement, neither Executive nor any person or entity acting with or on Executive's behalf, nor any person or entity under the control of or affiliated with Executive, shall, directly or indirectly, in any way Compete with the Company. Executive agrees that, if Executive has any business to transact on Executive's own account that is similar to the business entrusted to Executive by the Company, Executive shall notify the Company and always give preference to the Company's business. Executive agrees that such restrictions are fair and reasonable. For purposes of this Agreement, "**Compete**" means doing any of the following: (i) selling products or services to any person or entity that was or is (at any time, including during the Term and the period when the provisions of this paragraph are in effect) a client or customer of the Company (or its subsidiaries, affiliates or divisions) or on a list of prospective clients or customers of the Company, or

calling on, soliciting, taking away or accepting any such person or entity as a client or customer, or any attempt or offer to do any of the foregoing; (ii) entering into, or any attempt or offer to enter into, any business, enterprise or activity that is in any way similar to or otherwise competitive with the business that the Company (or its subsidiaries, affiliates or divisions) conducted at any time during the Term or any time the provisions of this paragraph are in effect, or (iii) directly or indirectly assisting any person or entity to take or attempt or offer to take any of the actions described in the foregoing clauses (i) or (ii).

8. **NOTICES**. Any notice, statement, request or consent made hereunder shall be in writing and shall be given as follows: (a) to Executive by Federal Express, or any other nationally recognized overnight carrier, addressed to Executive at his address stated as set forth in the preamble paragraph of this Agreement or at such other address as Executive may designate by notice to the Company as provided herein, and (b) to the Company by Federal Express or any other nationally recognized overnight carrier to the Company's s address stated as set forth in the preamble paragraph of this Agreement or to such other address as the Company may designate by notice to Executive as provided herein. Any such communication shall be deemed to have been given to Executive or the Company on the first business day following that mailing. In addition, any such communication may also be given by (i) personal delivery which shall be deemed to have been given upon delivery; (ii) facsimile which shall be deemed to have been given upon telephonic confirmation of successful transmission; or (iii) first class certified mail, return receipt requested, postage prepaid, addressed to the party to whom that notice is to be given and when notice is given in this manner it shall be deemed received on the third day after that notice was deposited with the United States Postal Service.

9. **ASSIGNMENT; SUCCESSORS**

9.1 **By Company**. This Agreement is fully assignable by the Company to any person or entity, including any successor entity; provided, however, that any such person or entity shall assume the Company's obligations under this Agreement in accordance with its terms.

9.2 **By Executive**. Executive may not assign this Agreement or any part of this Agreement without the Company's prior written consent, which consent may be given or withheld by the Company acting in its sole and absolute discretion.

10. **REMEDIES**.

10.1 **Uniform Trade Secrets Act**. If Executive breaches any provision of Section 6 of this Agreement, the Company shall have the right to invoke any and all remedies provided under the California Uniform Trade Secrets Act (California Civil Code §§3426, *et seq*.) or other statutes or common law remedies of similar effect.

10.2 **Non-Exclusive Remedies**. The remedies provided to the Company in this Section 10 are cumulative, and not exclusive, of any other remedies that may be available to the Company.

10.3 **Arbitration**. Any controversy, dispute or claim between the parties to this Agreement, including any claim arising out of, in connection with, or in relation to the

formation, interpretation, performance or breach of this Agreement or Executive's employment with the Company, shall be settled exclusively by arbitration, before a single arbitrator, in accordance with this Section and the then most applicable rules of the American Arbitration Association, except as modified by this Section 10.3, but only if one (or both) of the parties requests such arbitration. The arbitrator shall be bound by the express provisions of this Agreement and by the laws of the jurisdiction chosen by the parties to be the law governing the interpretation of this Agreement. The arbitrator shall permit such discovery as required by applicable law and as sufficient to adequately arbitrate Executive's statutory claims (if any have been asserted), including access to essential documents and witnesses where required by applicable law. Judgment upon any award rendered by the arbitrator may be entered by any state or federal court having jurisdiction thereof. Notwithstanding the foregoing, to the extent permitted by applicable law either party may in an appropriate manner apply to a court pursuant to California Code of Civil Procedure Section 1281.8, or any comparable provision, for provisional relief, including a temporary restraining order or a preliminary or permanent injunction (such as specified in Section 10.1 of this Agreement), on the ground that the award to which the applicant may be entitled in arbitration may be rendered ineffectual without provisional relief. Nor shall anything in this Section 10 (to the extent permitted by applicable law) prevent any party from (i) joining any party as a defendant in any action brought by or against a third party; (ii) bringing an action in court to effect any attachment or garnishment; or (iii) bringing an action in court to compel arbitration as required by this Section 10.

If the parties are unable to agree upon an arbitrator, the parties shall select a single arbitrator from a list of nine arbitrators drawn by the parties at random from the "Independent" (or "Gold Card") list of retired judges. If the parties are unable to agree upon an arbitrator from the list so drawn, then the parties shall each strike names alternately from the list, with the first strike being determined by lot. After each party has used four strikes, the remaining name on the list shall be the arbitrator. If such person is unable to serve for any reason, the parties shall repeat this process until an arbitrator is selected.

This agreement to resolve any disputes by binding arbitration shall extend to claims against any parent, subsidiary or affiliate of each party, and, when acting within such capacity, any officer, director, shareholder, employee or agent of each party, or of any of the above, and shall apply as well to claims arising out of state and federal statutes and local ordinances as well as to claims arising under the common law. In the event of a dispute subject to this Section 10 the parties shall be entitled to reasonable discovery subject to the discretion of the arbitrator. The remedial authority of the arbitrator shall be the same as, but no greater than, would be the remedial power of a court having jurisdiction over the parties and their dispute. The arbitrator shall, upon an appropriate motion, dismiss any claim without an evidentiary hearing if the party bringing the motion establishes that he or she would be entitled to summary judgment if the matter had been pursued in court litigation.

To the extent permitted by law, the initial fees and costs of the arbitrator shall be borne by the Company, with the Company being responsible for the costs and fees of

the arbitration and the prevailing party shall be entitled to reimbursement for legal fees and costs incurred by the other.

The arbitrator shall render an award and written opinion, and the award shall be final and binding upon the parties.

Any arbitration shall take place in the county of Los Angeles, California.

THE PARTIES UNDERSTAND THAT BY AGREEING TO ARBITRATE IN THE MANNER REQUIRED BY THIS SECTION 10, THEY ARE WAIVING THEIR RIGHTS TO HAVE ANY DISPUTE ARISING OUT OF THIS AGREEMENT OR EXECUTIVE'S EMPLOYMENT BY THE COMPANY TRIED BEFORE AND ADJUDICATED BY A JURY, INCLUDING DISPUTES RELATING TO ANY CLAIM EXECUTIVE MAY HAVE FOR UNLAWFUL TERMINATION OF HER EMPLOYMENT OR FOR A VIOLATION OF ANY FEDERAL, STATE OR OTHER LAW OR STATUTORILY PROTECTED RIGHTS, (SUCH AS, WITHOUT LIMITATION, AGE DISCRIMINATION IN EMPLOYMENT ACT, AS AMENDED, 29 U.S.C. §§ 621—634; OLDER WORKERS BENEFIT PROTECTION ACT, AS AMENDED, 29 U.S. §§ 621, 623; TITLE VII OF THE CIVIL RIGHTS ACT OF 1964, AS AMENDED, 42 U.S.C. §§ 2000E—2000E-17; THE FAIR LABOR STANDARDS ACT OF 1938 AS AMENDED; THE EQUAL PAY ACT OF 1963, AS AMENDED, 29 U.S.C. §§ 206(D); THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974, AS AMENDED, 29 U.S.C. §§ 1001—1461; THE WORKER ADJUSTMENT AND RETRAINING NOTIFICATION ACT, AS AMENDED, 29 U.S.C. § 2101 *ET SEQ*.; THE NATIONAL LABOR RELATIONS ACT, AS AMENDED, 29 U.S.C. §§ 151-169; FAMILY AND MEDICAL LEAVE ACT OF 1993, AS AMENDED, 29 U.S.C. § 825 *ET SEQ*. AMERICANS WITH DISABILITY ACT OF 1990, AS AMENDED, 42 U.S.C. §§ 12101 ET. SEQ.; INFLICTION OF EMOTIONAL DISTRESS, DEFAMATION, PERSONAL INJURY AND BREACH OF CONTRACT, WHICH INCLUDE DISCRIMINATION ON THE BASIS OF AGE, RACE, GENDER, DISABILITY, ETHNIC ORIGIN OR SEXUAL ORIENTATION). NEVERTHELESS, BOTH PARTIES AGREE TO WAIVE ALL SUCH RIGHTS THEY MAY HAVE TO A JURY TRIAL AND TO SUBMIT ALL SUCH DISPUTES TO BINDING ARBITRATION IN ACCORDANCE WITH THE TERMS OF THIS SECTION 10.

Company /s/ EEE _____ **Executive** /s/ CB _____

(initials) **(initials)**

11. **NO CONFLICT**. Executive represents and warrants that neither his execution of this Agreement nor his performance under this Agreement will (i) violate, conflict with or result in a breach of any provision of, or constitute a default (or an event that, with notice or lapse of time, or both, would constitute a default) under, any contract or other obligation to which Executive is a party or by which he is bound; or (ii) violate any judgment or other order applicable to Executive. Executive shall indemnify, defend and

hold harmless the Company from and against any and all claims, liabilities, lawsuits, judgments, losses, costs, fees and expenses (including reasonable attorneys' fees, costs and expenses) that the Company or any of its agents, affiliates, employees, shareholders, officers or directors may suffer or incur as a result of Executive's breach or alleged or threatened breach of any of the representations and warranties set forth in this paragraph.

12. **GENERAL**.

12.1 **Captions**. The section headings contained in this Agreement are for reference purposes only and shall not in any way affect the meaning or interpretation of this Agreement.

12.2 **Entire Agreement**. This Agreement sets forth the entire agreement and understanding of the parties with regard to the subject matter hereof and supersedes all prior agreements, arrangements and understandings, written or oral, between the parties.

12.3 **Amendments; Waivers**. This Agreement may be amended, modified, superseded, canceled, renewed or extended, and the terms or covenants of this Agreement may be waived, only by a written instrument executed by both of the parties hereto, or in the case of a waiver, by the party waiving compliance. The failure of either party at any time or times to require performance of any provision of this Agreement shall in no manner affect such party's right at a later time to enforce such performance. No waiver by either party of the breach of any term or covenant contained in this Agreement, whether by conduct or otherwise, in any one or more instances, shall be deemed to be, or construed as, a further or continuing waiver of any such breach, or a waiver of the breach of any other term or covenant contained in this Agreement.

12.4 **No Other Representations**. No representation, promise or inducement has been made by either party that is not embodied in this Agreement, and neither party shall be bound by or be liable for any alleged representation, promise or inducement not so set forth.

12.5 **Severability**. If any of the provisions of this Agreement (including Section 10) are determined to be unlawful or otherwise unenforceable, in whole or in part, such determination shall not affect the validity of the remainder of this Agreement, and this Agreement shall be reformed to the extent necessary to carry out its provisions to the greatest extent possible and, with respect to reformation of any provision of Section 10, to ensure that the resolution of all conflicts between the parties (including those arising out of statutory claims) shall be resolved by neutral, binding arbitration. If a court should find that any provision set forth in Section 10 is not absolutely binding, the parties intend that any arbitration decision and award with respect to this Agreement be fully admissible in evidence in any subsequent action, given great weight by any finder of fact, and treated as determinative to the maximum extent permitted by law.

12.6 **Counterparts**. This Agreement may be executed in one or more counterparts, each of which shall be deemed an original, and it shall not be necessary in making proof of this Agreement, to produce or account for more than one such counterpart.

12.7 **Withholding**. Notwithstanding anything in this Agreement to the contrary, all payments that the Company is required to make under this Agreement to Executive or Executive's estate or beneficiaries shall be subject to the withholding of such amounts relating to taxes as the Company may reasonably determine it should withhold pursuant to any applicable law or regulation.

12.8 **Tax Consequences**. The Company shall have no obligation to any person entitled to the benefits of this Agreement with respect to any tax obligation any such person incurs as a result of or attributable to this Agreement, including any supplemental agreements, stock option plans or employee benefit plans, or arising from any payments made or to be made under this Agreement or thereunder.

12.9 **Consent to Jurisdiction**. The parties to this Agreement agree that all actions or proceedings arising directly or indirectly from this Agreement shall be arbitrated or litigated before arbitrators or in courts having a situs within Loa Angeles, California; hereby consent to the jurisdiction of any local, state or federal court in which such an action or proceeding is commenced that is located in Los Angeles County, California; agree not to disturb such choice of forum (including waiving any argument that venue in any such forum is not convenient); agree that any litigation initiated by any party hereto in connection with this Agreement may be venued in either the state or federal courts located in Orange County, California; agree that a final judgment in any such action or proceeding shall be conclusive and may be enforced in other jurisdictions by suit on the judgment or in any other manner provided by law; and waive the personal service of any and all process upon them and consent that all such service of process may be made by certified or registered mail, return receipt requested, addressed to the respective parties at the address set forth above.

12.10 **Gender References**. References in this Agreement to any gender shall include the masculine, feminine and neuter genders.

[remainder of page intentionally left blank]

12.11 **Construction**. In all instances when appearing in this Agreement, the terms "including," "include" and "includes" shall be deemed to be followed by "without limitation."

IN WITNESS WHEREOF, the parties have duly executed this Agreement as of the date first above written.

SAVE THE WORLD AIR, INC.

By: /s/ Eugene E. Eichler
EUGENE E. EICHLER
Title: Acting Chief Executive Officer

EXECUTIVE:

/s/ Charles Blum
CHARLES BLUM

EXHIBIT 31.1

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, Eugene E. Eichler, certify that:

1. I have reviewed this Quarterly Report on Form 10-QSB 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)) for the registrant and have:

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

(b) 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

(c) 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: July 24, 2007

/s/ EUGENE E. EICHLER
Eugene E. Eichler
Acting Chief Executive Officer

EXHIBIT 31.2

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, Charles K. Dargan II, certify that:

1. I have reviewed this Quarterly Report on Form 10-QSB 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)) for the registrant and have:

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

(b) 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

(c) 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: July 24, 2007

/s/ CHARLES K. DARGAN II
Charles K. Dargan II
Chief Financial Officer

EXHIBIT 32

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-QSB of the Company for the quarter ended March 31, 2007 (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: July 24, 2007

/s/ EUGENE E. EICHLER
Eugene E. Eichler
Acting Chief Executive Officer

Date: July 24, 2007

/s/ CHARLES K. DARGAN II
Charles K. Dargan II
Chief Financial Officer