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

FORM 10-Q

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

For the quarterly period ended June 30, 2011
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.)*

735 State Street, Suite 500
Santa Barbara, California 93101
(Address, including zip code, of principal executive offices

(805)-845-3561
(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 x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

Large accelerated filer o Accelerated filer o

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

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

The number of shares of the Registrant's Common Stock outstanding as of July 29, 2011 was 107,784,042.

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

		June 30, 2011 (unaudited)		December 31, 2010
ASSETS				
Cash	$	448,362	$	101,645
Other current assets		53,508		29,425
Total current assets		501,870		131,070
Property and Equipment, net of accumulated depreciation of $194,897 and $178,246 at June 30, 2011 and December 31, 2010, respectively		92,383		78,083
Other assets		10,330		8,020
Total assets	$	604,583	$	217,173
LIABILITIES AND STOCKHOLDERS' DEFICIENCY				
Current liabilities				
Accounts payable-related parties	$	76,183	$	241,176
Accounts payable-license agreements		—		721,785
Accounts payable-other		513,147		450,411
Accrued expenses		839,298		959,827
Accrued professional fees		302,354		431,704
Loans payable-related parties and shareholders		63,464		86,947
Convertible debentures, net-of- discount		165,811		76,947
Fair value of derivative liabilities		2,101,091		3,664,675
Total current liabilities		4,061,348		6,633,472
Commitments and contingencies				
Stockholders' deficiency				
Common stock, $.001par value: 200,000,000 shares authorized, 106,397,658 and 91,453,194, shares issued and outstanding at June 30, 2011 and December 31, 2010, respectively		106,398		91,453
Common stock to be issued (200,000 shares at June 30, 2011)		120,000		—
Additional paid-in capital		60,009,018		51,925,168
Deficit accumulated during the development stage		(63,692,181)		(58,432,920)
Total stockholders' deficiency		(3,456,765)		(6,416,299)
Total liabilities and stockholders' deficiency	$	604,583	$	217,173

See notes to condensed consolidated financial statements.

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

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

	Three months ended June 30, 2011	Three months ended June 30, 2010	Six months ended June 30, 2011	Six months ended June 30, 2010	Inception (February 18, 1998) to June 30, 2011
Net sales	$ —	$ —	$ —	$ —	$ 69,000
Cost of goods sold	—	—	—	—	24,120
Gross profit	—	—	—	—	44,880
Operating expenses	1,428,251	1,058,433	2,511,235	2,621,969	39,769,189
Research and development expenses	81,213	29,802	552,568	204,095	6,867,282
Non-cash patent settlement costs	—	—	—	—	1,610,066
Loss before other income (expense)	(1,509,464)	(1,088,235)	(3,063,803)	(2,826,064)	(48,201,657)
Other income (expense)					
Other income (expense)	(26,913)	—	38,450	5,196	182,422
Interest income	—	—	—	—	16,342
Interest and financing expense	(3,205,280)	(1,366,142)	(3,796,692)	(2,774,021)	(15,389,056)
Change in fair value of derivative liabilities	345,987	2,509,892	1,563,584	1,271,129	1,670,249
Costs of private placement	—	—	—	(1,129,212)	(1,640,715)
Costs to induce conversion of notes	—	(168,340)	—	(168,340)	(469,043)
Loss on disposition of equipment	—	—	—	—	(14,426)
Settlement of Debt Due Morale/Matthews	—	—	—	—	(927,903)
Settlement of litigation and debt	—	—	—	—	1,089,088
Loss before provision for income taxes	(4,395,670)	(112,825)	(5,258,461)	(5,621,312)	(63,684,699)
Provision for income taxes	800	—	800	800	7,482
Net loss	$ (4,396,470)	$ (112,825)	$ (5,259,261)	$ (5,622,112)	$ (63,692,181)
Net loss per share, basic and diluted	$ (0.04)	$ (0.00)	$ (0.06)	$ (0.07)	
Weighted average common shares outstanding, basic and diluted	100,431,182	81,821,945	91,277,666	77,759,835	

See notes to condensed consolidated financial statements.

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

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' DEFICIENCY (UNAUDITED)
SIX MONTHS ENDED JUNE 30, 2011

	Price per Share	Total Stockholders' Shares	Total Stockholders' Amount	Common Stock to be Issued	Additional Paid-in Capital	Deficit Accumulated During the Development Stage	Total Stockholders' Deficiency
Balance, December 31, 2010		91,453,194	$ 91,453	$ —	$ 51,925,168	$ (58,432,920)	$ (6,416,299)
Common stock issued for conversion of convertible debt	$.25	14,785,666	14,786	—	3,681,631	—	3,696,417
Common stock issued upon exercise of warrants	$.47	81,020	81	—	(81)	—	—
Fair value of options issued as compensation	—	—	—	—	565,248	—	565,248
Common stock issued for services	—	—	—	120,000	—	—	120,000
Common stock issued upon exercise of options	$.27	77,778	78	—	20,922	—	21,000
Fair value of warrants and beneficial conversion feature of issued convertible notes	—	—	—	—	3,689,066	—	3,689,066
Fair value of warrants issued for services	—	—	—	—	127,064	—	127,064
Net loss for the six months ended June 30, 2011	—	—	—	—	—	(5,259,261)	(5,259,261)
Balance, June 30, 2011		106,397,658	$ 106,398	$ 120,000	$ 60,009,018	$ (63,692,181)	$ (3,456,765)

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)

	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010	Inception (February 18, 1998) to June 30, 2011
Cash flows from operating activities			
Net Loss	$ (5,259,261)	$ (5,622,112)	$ (63,692,181)
Adjustments to reconcile net loss to net cash used in operating activities:			
Write off of intangible assets	—	—	505,000
Settlement of litigation and debt	(65,363)	—	(1,227,683)
Settlement of debt due Morale/Matthews	—	—	927,903
Stock based compensation expense	565,248	175,983	4,500,404
Issuance of common stock for services	120,000	713,637	7,292,788
Issuance of options for legal settlement	—	—	31,500
Issuance of warrants for legal settlement	—	—	4,957
Issuance of warrants for financing fees	—	—	153,501
Issuance of warrants for consulting fees	127,064	218,954	253,064
Increase in convertible notes related to default	1,877	33,113	298,356
Interest on related party loans	—	—	22,305
Patent acquisition cost	—	—	1,610,066
Amortization of issuance costs and original issue debt discounts including beneficial conversion feature-part of interest expense	3,783,405	2,734,494	14,848,036
Fair value of common stock and warrants issued to induce conversion of notes	—	168,340	469,043
Costs of private placement convertible notes	—	1,129,212	1,640,715
Change in fair value of derivative liability	(1,563,584)	(1,271,129)	(1,670,249)
Amortization of deferred compensation	—	—	3,060,744
Loss on disposition of assets	—	—	14,426
Depreciation and amortization of leasehold improvements	16,651	17,287	476,833
Bad debt	—	—	1,300
Changes in operating assets and liabilities:			
Accounts receivable	—	—	(1,380)
Inventory	—	—	—
Prepaid expenses and other	(24,083)	(17,181)	(53,428)
Other assets	(2,310)	—	(10,330)
Accounts payable and accrued expenses	115,992	(185,455)	4,728,323
Accounts payable – license agreements	(656,422)	(75,987)	(651,137)
Accounts payable – related parties	(164,993)	23,240	(16,820)
Net cash used in operating activities	(3,005,779)	(1,957,604)	(26,483,944)
Cash flows from investing activities			
Purchase of equipment	(30,951)	(11,235)	(597,570)
Proceeds from sale of equipment	—	—	17,478
Net cash used in investing activities	(30,951)	(11,235)	(580,092)
Cash flows from financing activities			
Net proceeds under equity line of credit	—	—	1,262,386
(Decrease) increase in payables to related parties and stockholder	(23,483)	(6,945)	600,443
Advances from founding executive officer	—	—	517,208
Net proceeds from issuance of convertible notes and warrants	3,393,430	1,929,755	14,598,408
Repayment of convertible notes	—	—	(282,121)
Proceeds from sale of stock and exercise of warrants and options	13,500	15,300	10,816,074
Net cash provided by financing activities	3,383,447	1,938,110	27,512,398
Net increase in cash	346,717	(30,729)	448,362
Cash, beginning of period	101,645	33,611	—
Cash, end of period	$ 448,362	$ 2,882	$ 448,362

(continued)

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

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
(continued)

	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010	Inception (February 18, 1998) to June 30, 2011
Supplemental disclosures of cash flow information			
Cash paid during the year for:			
Interest	$ 9,895	$ 512	$ 169,261
Income taxes	$ 800	$ 800	$ 7,482
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	—	4,121	247,584
Cancellation of stock	—	—	8,047
Conversion of accounts payable and accrued expenses to common stock	—	—	612,521
Conversion of accounts payable and accrued expenses to convertible debentures	295,635	281,199	626,835
Conversion of related party debt to convertible debentures	—	22,500	72,500
Conversion of convertible debentures to common stock	3,696,417	3,187,581	14,482,398
Issuance of shares for settlement of loans and other payable to Morale/Matthews	—	—	2,783,711
Write off of deferred compensation	—	—	142,187
Fair value of derivative liability recorded as note discount	—	1,243,625	2,130,625
Proceeds of exercise of options applied to accounts payable	7,500	—	67,500
Fair value of warrants and beneficial conversion feature associated with issued convertible notes	3,689,066	935,330	11,935,454

See notes to condensed consolidated financial statements.

1. Organization and basis of presentation

Description of business

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

The Company was incorporated on February 18, 1998, as a Nevada corporation, under the name Mandalay Capital Corporation. The Company changed its name to Save the World Air, Inc. on February 11, 1999, following the acquisition of marketing and manufacturing rights of the ZEFS technologies. Our executive offices are at 735 State Street, Suite 500, Santa Barbara, California 93101. The telephone number is (805)-845-3561. Our research and development facility is at 235 Tennant Avenue, Morgan Hill, California 95037. The telephone number is (408) 778-0101. The corporate website is www.stwa.com. The common stock is quoted under the symbol "ZERO" on the Over-the-Counter Bulletin Board

The Company's technology has two commercial applications; AOT™ (Applied Oil Technology) and ELEKTRA™ and legacy technologies of ZEFS and MK IV. AOT™ and ELEKTRA™ are nearing the end of the product development cycle, which will culminate at the U.S. Department of Energy's Rocky Mountain Oilfield Testing Center (RMOTC). We believe the testing of AOT™ at the RMOTC will determine the value of savings the product presents at full scale operation on an active pipeline.

The AOT™ and ELEKTRA™ are technologies which use electric fields to alter some physical properties of petrochemical fluids to reduce viscosity of the fluids. The Company differentiates AOT™ and ELEKTRA™ products based on their differing attributes and marketing focus. AOT™ products are primarily designed to reduce operation costs for oil pipelines, and ELEKTRA™ products are primarily designed to improve fuel economy and reduce emissions from diesel-powered internal combustion engines. Our AOT™ products are intended to reduce the viscosity of crude oil, thereby making it less restrictive to pipeline transport. Our AOT™ products will be marketed primarily to pipeline operators as well as to pilot and government mandated delivery programs. Our ELEKTRA™ products are intended to increase fuel efficiency and reduce emissions. ELEKTRA™ will be marketed primarily to specialty consumer accessories market for many types of diesel-fueled vehicles, including but not limited to trucks, trains, maritime, military and aviation.

Basis of presentation

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

The condensed consolidated balance sheet information as of December 31, 2010 was derived from the audited consolidated financial statements included in the Company's Annual Report on Form 10-K filed with the SEC. These interim financial statements should be read in conjunction with that report.

Going concern

Since its inception, the Company has been primarily engaged in organizational and pre-operating activities. The Company has generated insignificant revenues and has incurred accumulated losses of $63,692,181 from February 18, 1998 (Inception) through June 30, 2011. As reflected in the accompanying condensed consolidated financial statements, the Company had a net loss of $5,259,261 and a negative cash flow from operations of $3,005,779 for the six months ended June 30, 2011, and had a working capital deficiency (excluding derivative liabilities) of $1,458,387 and a stockholders' deficiency of $3,456,765 at June 30, 2011. As a result, the Company’s independent registered public accounting firm, in their report on the Company’s 2010 consolidated financial statements, raised substantial doubt about the Company’s ability to continue as a going concern. The financial statements do not include any adjustments that might be necessary if the Company is unable to continue as a going concern.

On March 28, 2011, the Company completed its final adjusted payment to Temple University for all outstanding obligations on the License Agreements and the R&D Agreement.

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 Company’s operations from inception, February 18, 1998 to June 30, 2011 have been funded through issuances of its common stock and convertible notes. During this period, the Company raised an aggregate of $25,414,482 of which $14,598,408 was from the sale of convertible notes. As of June 30, 2011, the outstanding balance of convertible notes was $827,764, of which $791,950 represented the 2011 Winter and Spring Offerings which closed February 28, 2011 and May 31, 2011 respectively (see “Note 4. Convertible Debentures”). The Company expects substantially all of the outstanding notes will be converted into shares of common stock of the Company.

On June 30, 2011, the Company had cash on hand in the amount of $448,362. In addition to the funds on hand, the Company will require additional funds to continue to operate our business. This includes expenses we will incur in connection with license agreements; product development and commercialization of the AOT and ELEKTRA technologies; 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, the Company has contractual commitments for salaries to one of the executive officers pursuant to an employment agreement, severance payments to a former officer and consulting fees, during 2011 and beyond. In light of the Company’s financial commitments over the next several months and its liquidity constraints, we have implemented cost reduction measures in all areas of operations. The Company intends to review these measures on an ongoing basis and make additional decisions as may be required.

2. Summary of significant accounting policies

Development stage enterprise

The Company is a development stage enterprise. 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 operation costs of petrochemical pipeline transport and fuel efficiency of diesel engines and has not yet generated meaningful revenues. The technologies are called “AOT” and “ELEKTRA”. The Company is currently in the mid-late stages of developing its AOT™ and ELEKTRA™ technologies for commercial applications. Expenses have been funded though 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 AOT™ and ELEKTRA™ technologies and is the worldwide exclusive licensee for patent pending technologies associated with the development of ELEKTRA™.

Estimates

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

Loss per share

Basic loss per share is computed by dividing net loss available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted loss per share reflects the potential dilution, using the treasury stock method that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the loss of the Company. In computing diluted loss per share, the treasury stock method assumes that outstanding options and warrants are exercised and the proceeds are used to purchase common stock at the average market price during the period. Options and warrants may have a dilutive effect under the treasury stock method only when the average market price of the common stock during the period exceeds the exercise price of the options and warrants. For the six month period ended June 30, 2011 and 2010, the dilutive impact of outstanding stock options of 22,177,892 and 4,976,376 respectively, and outstanding warrants of 37,701,079 and 19,932,339 have been excluded because their impact on the loss per share is anti-dilutive.

Stock-Based Compensation

The Company periodically issues stock options and warrants to employees and non-employees in non-capital raising transactions for services and for financing costs. The Company accounts for stock option and warrant grants issued and vesting to employees based on the authoritative guidance provided by the Financial Accounting Standards Board whereas the value of the award is measured on the date of grant and recognized over the vesting period. The Company accounts for stock option and warrant grants issued and vesting to non-employees in accordance with the authoritative guidance of the Financial Accounting Standards Board whereas the value of the stock compensation is based upon the measurement date as determined at either a) the date at which a performance commitment is reached, or b) at the date at which the necessary performance to earn the equity instruments is complete. Non-employee stock-based compensation charges generally are amortized over the vesting period on a straight-line basis. In certain circumstances where there are no future performance requirements by the non-employee, option grants are immediately vested and the total stock-based compensation charge is recorded in the period of the measurement date.

The fair value of the Company's common stock option grant is estimated using the Black-Scholes option pricing model, which uses certain assumptions related to risk-free interest rates, expected volatility, expected life of the common stock options, and future dividends. Compensation expense is recorded based upon the value derived from the Black-Scholes option pricing model, and based on actual experience. The assumptions used in the Black-Scholes option pricing model could materially affect compensation expense recorded in future periods.

Accounting for Warrants and Derivatives

The Company evaluates all of its financial instruments to determine if such instruments are derivatives or contain features that qualify as embedded derivatives. For derivative financial instruments that are accounted for as liabilities, the derivative instrument is initially recorded at its fair value and is then re-valued at each reporting date, with changes in the fair value reported in the consolidated statements of operations. For stock-based derivative financial instruments, the Company uses a probability weighted average series Black-Scholes-Merton option pricing models to value the derivative instruments at inception and on subsequent valuation dates.

The classification of derivative instruments, including whether such instruments should be recorded as liabilities or as equity, is evaluated at the end of each reporting period. Derivative instrument liabilities are classified in the balance sheet as current or non-current based on whether or not net-cash settlement of the derivative instrument could be required within 12 months of the balance sheet date.

Fair value of financial instruments

Effective January 1, 2008, fair value measurements are determined by the Company's adoption of authoritative guidance issued by the FASB, with the exception of the application of the statement to non-recurring, non-financial assets and liabilities as permitted. The adoption of the authoritative guidance did not have a material impact on the Company's fair value measurements. Fair value is defined in the authoritative guidance as the price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. A fair value hierarchy was established, which prioritizes the inputs used in measuring fair value into three broad levels as follows:

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

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

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

The Company is required to use observable market data if such data is available without undue cost and effort

The following table presents certain investments and liabilities of the Company’s financial assets measured and recorded at fair value on the Company’s condensed consolidated balance sheets on a recurring basis and their level within the fair value hierarchy as of June 30, 2011 and December 31, 2010.

	Level 1	Level 2	Level 3	Total
Fair value of Derivative Liability – June 30, 2011	$ -0-	$ -0-	$ 2,101,091	$ 2,101,091
Fair value of Derivative Liability - December 31, 2010	$ -0-	$ -0-	$ 3,664,675	$ 3,664,675

Recent Accounting Pronouncements

In May 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-4, which amends the Fair Value Measurements Topic of the Accounting Standards Codification (ASC) to help achieve common fair value measurement and disclosure requirements in U.S. GAAP and IFRS. ASU No. 2011-4 does not require additional fair value measurements and is not intended to establish valuation standards or affect valuation practices outside of financial reporting. The ASU is effective for interim and annual periods beginning after December 15, 2011. The Company will adopt the ASU as required. The ASU will affect the Company's fair value disclosures, but will not affect the Company's results of operations, financial condition or liquidity.

In June 2011, the FASB issued ASU No. 2011-5, which amends the Comprehensive Income Topic of the ASC. The ASU eliminates the option to present the components of other comprehensive income as part of the statement of changes in shareholders' equity, and instead requires consecutive presentation of the statement of net income and other comprehensive income either in a continuous statement of comprehensive income or in two separate but consecutive statements. ASU No. 2011-5 is effective for interim and annual periods beginning after December 15, 2011. The Company will adopt the ASU as required. It will have no affect on the Company's results of operations, financial condition or liquidity.

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

3. Certain relationships and related transactions

Loans from related parties

As at June 30, 2011, and December 31, 2010, the Company had loan payable to an officer of the Company in the amount of $63,464 and $86,947, respectively. These loans are unsecured, are due on demand and bear interest at 6% per annum. On July 6, 2011, the Company made a partial payment of $40,000, bringing down the balance of these loans to $23,464.

Accounts Payable to related parties

As of June 30, 2011 and December 31, 2010, the Company had accounts payable to related parties in the amount of $76,183 and $241,176, respectively. These amounts are unpaid Directors Fees and expenses incurred by officers and directors.

4. Convertible Debentures

Convertible debentures consist of the following:

	Maturity dates	June 30, 2011	December 31, 2010
2008 Winter Offering	December 5, 2009	6,997	6,697
2009 Spring	April 30, 2010	6,755	6,455
2009 Wellfleet	September 28, 2012	—	27,011
2009 Fall Offering	January 15, 2012	11,062	37,409
2010 Fall Offering #2	November 30, 2011	11,000	386,760
2011 Winter Offering	February 28, 2012	292,050	—
2011 Spring Offering	May 31, 2012	499,900	—
Sub-total		827,764	464,332
Less, remaining debt discount		(661,953)	(387,385)
Convertible debentures, net		$ 165,811	76,947

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

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

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

As June 30, 2011, investors have converted $519,200 of the Convertible Notes into 3,054,117 shares of the Company's common stock. As of June 30, 2011, one note for $5,500 was in default and outstanding ($6,997 in total including $1,497 in penalties and interest).

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

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

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

As of June 30, 2011, investors have converted $176,000 of the Convertible Notes plus penalty and interest of $7,538 into 679,768 shares of the Company's common stock. As of June 30, 2011, one note in the amount of $5,500 was in default and outstanding ($6,755 in total which includes $1,255 of penalty and interest).

2009 Wellfleet Offering. On November 20, 2009, the Company completed a private financing of $75,000 principal amount of 7% Convertible Promissory Notes (the "Notes") due September 28, 2012 and 300,000 Common Stock Purchase Warrants exercisable at $.30 per share (the "Warrants"), pursuant to a Securities Purchase Agreement (the "Purchase Agreement") with 3 accredited investors (the "Note Offering"), through Sandgrain Securities, Inc., as placement agent.

The Notes are initially convertible into the Company's common stock at a price of $.25 per share and accrue interest at 7% per year with a default rate of 10%, payable quarterly in cash. Interest payments are payable in stock at the sole discretion of the Note holders, or, in the event that shares issuable thereon are registered under the Securities Act of 1933, as amended (the "**Act**"), or otherwise freely tradable pursuant to Rule 144, at the discretion of the Company as well. The Notes and any unpaid interest are due and fully payable on September 28, 2012. The conversion price of the Notes is adjustable for corporate events such as merger, reclassification or stock splits.

Pursuant to the terms of the Purchase Agreement, and among other terms, in the event the Company conducts any subsequent financings (each, a "Follow On Offering") of any kind other than an offering of securities substantially similar to the Notes and Warrants or certain other exempted issuances enumerated in the Notes, the Notes may, at the discretion of each holder thereof, be exchanged in whole or in part to the extent of outstanding principal and/or interest in such Note, into the securities offered in the Follow On Offering, by applying and exchanging the outstanding principal and interest of such Notes towards the purchase price of the securities offered in such Follow On Offering, at the same price and terms of the Follow On Offering.

The Company paid a placement agent fee to Sandgrain Securities, Inc. of (i) $6,000 in cash, (ii) 24,000 shares of Common Stock constituting 8% of the number of Conversion Shares initially issuable upon exercise of the Notes, and (iii) 24,000 warrants, substantially similar to the Warrants sold to investors (the "Placement Agent Warrants"), in connection with the Note Offering, in addition to legal fees.

Each of the warrant agreements included an anti-dilution provision that allowed for the automatic reset of the exercise price upon any future sale of common stock or warrants at or below the current exercise price. The Company considered the current Financial Accounting Standards Board guidance of "Determining Whether an Instrument Indexed to an Entity's Own Stock" which indicates that any adjustment to the fixed amount (either conversion price or number of shares) of the instrument regardless of the probability or whether or not within the issuers' control, means the instrument is not indexed to the issuers own stock. Accordingly, the Company determined that as the strike price of these warrants contain exercise prices that may fluctuate based on the occurrence of future offerings or events, and as such is not a fixed amount. As a result, the Company determined that these warrants are not considered indexed to the Company's own stock and characterized the fair value of these warrants as derivative liabilities upon issuance.

The Company determined that the fair value of the warrant liability at issuance on November 20, 2009 to be $75,000 based upon a probability weighted average Black-Sholes-Merton calculation. The Company recorded the full value of the derivative as a liability at issuance with an offset to valuation discount. The fair value of the warrant liability as of June 30, 2011 was $24,735 (see Note 8).

As of June 30, 2011, investors have converted $75,000 of the Convertible Notes plus $4,664 of accrued interest into 318,656 shares of the Company's common stock. There was no outstanding balance as of June 30, 2011.

2009 Fall Offering. From October 2, 2009 to January 15, 2010, the Company conducted and completed a private offering (the "Fall 2009 Offering") consisting of an aggregate of $1,588,125 of 7% Convertible Promissory Notes (the "Notes") with interest compounded quarterly at the annual rate of 7% payable at maturity, and warrants to purchase an aggregate of 6,352,500 shares of our common stock (the "Fall 2009 Warrants"). The Company received $1,284,425 net proceeds, of which $344,500 was received as of December 31, 2009. The Fall 2009 Notes mature on the second anniversary of the closing of this offering and will be convertible, at the option of the note holder, into up to 6,352,500 shares of our common stock at a conversion price of $0.25 per share. The Fall 2009 Warrants are for a term of three years at an exercise price of $0.30 per share.

Each of the warrant agreements included an anti-dilution provision that allowed for the automatic reset of the exercise price upon any future sale of common stock or warrants at or below the current exercise price. The Company considered the current Financial Accounting Standards Board guidance of "Determining Whether an Instrument Indexed to an Entity's Own Stock" which indicates that any adjustment to the fixed amount (either conversion price or number of shares) of the instrument regardless of the probability or whether or not within the issuers' control, means the instrument is not indexed to the issuers own stock. Accordingly, the Company determined that as the strike price of these warrants contain exercise prices that may fluctuate based on the occurrence of future offerings or events, and as such is not a fixed amount. As a result, the Company determined that these warrants are not considered indexed to the Company's own stock and characterized the fair value of these warrants as derivative liabilities upon issuance.

The Company determined that the fair value of the warrant liability at issuances to be $3,027,815 based upon a probibility weighted average Black-Scholes-Merton calculation (See Note 8), of which, $654,978 was recorded on December 31, 2009 and $2,372,837 was recorded on January 15, 2010. The Company recorded the full value of the derivative of $2,372,837 as a liability at issuance with an offset to valuation discount. As the fair value of the liability of $2,372,837 exceeded the note value of $1,243,625, the excess of the liability over the note amount of $1,129,212 was considered to be cost of the private placement and was charged to expense upon issuance. The fair value of the warrant liability as of June 30, 2011 was $1,613,819 (see Note 8).

As of June 30, 2011, investors have converted $1,578,125 of the Convertible Notes plus interest of $11,502 into 6,358,507 shares of the Company's common stock. The outstanding balance at June 30, 2011 was $11,062 which includes $1,062 in accrued interest.

2010 Fall Offering #2

From October 4, 2010 to November 30, 2010, the Company conducted and concluded a private offering (the "Fall 2010 Offering #2") consisting of up to $3,000,000 aggregate face amount of its convertible notes (the " Fall 2010 Notes). A total of $940,347 Fall 2010 #2 Notes were sold to ten accredited investors for an aggregate purchase price of $849,861. While there was no stated interest rate on the Fall 2010 #2 Notes, the implied effective interest rate on the Fall 2010 #2 Notes is 10% per annum. The Fall 2010 #2 Notes mature on the first anniversary of the closing of this offering and will be convertible, at the option of the noteholder into 3,761,386 shares of the Company's common stock at a conversion price of $0.25 per share (the "Conversion Price").

Each of the investors in the Fall 2010 #2 Offering will receive, for no additional consideration, a warrant (the "Fall 2010 #2 Warrants"), entitling the holder to purchase a number of shares of our common stock equal to 100% of the number of shares of common stock into which the Fall 2010 #2 Notes are convertible (the "Warrant Shares"). Each Fall 2010 Warrant is exercisable on a cash basis only at an initial price of $0.30 per share, and is exercisable for a period of twenty four months. Up to 3,761,386 Warrant Shares are initially issuable on exercise of the Fall 2010 #2 Warrants.

The Company received $849,861 in net proceeds in the Fall 2010 #2 Offering which was used for general corporate purposes and working capital. The aggregate value of the Fall 2010 #2 Offering Warrants issued were valued at $436,986 using the Black-Scholes-Merton option valuation model with the following assumptions; risk-free interest rate of .27; dividend yield of 0%; volatility factors of the expected market price of common stock of 121%; and an expected life of two years (statutory term) and vest immediately upon issuance. The Company also determined that the notes contained a beneficial conversion feature of $417,875. As of June 30, 2011, the aggregate value of the Fall 2010 #2 Offering Warrants, the beneficial conversion feature and the implied discount and transaction fees of $85,486 are considered as debt discount and will be amortized over the life of the notes.

As of June 30, 2011, investors have converted $929,347 of the Convertible Notes into 3,717,386 shares of the Company's common stock. The outstanding balance at June 30, 2011 was $11,000.

2011 Winter Offering

From December 13, 2010 through February 28, 2011, the Company conducted a private offering (the "Winter 2011 Offering") of up to $3,000,000 aggregate face amount of its convertible notes (the "Winter 2011 Notes"). A total of $2,588,422 aggregate face amount of the Winter 2011 Notes were sold for an aggregate purchase price of $2,353,111. While there was no stated interest rate on the Winter 2011 Notes, the implied effective interest rate on the Winter 2011 Notes is 10% per annum. The Winter 2011 Notes mature on the first anniversary of their date of issuance. The Winter 2011 Notes are convertible, at the option of the note holder, into 10,353,688 shares of common stock of the Company (the "Conversion Shares") at an initial conversion price of $0.25 per share (the "Conversion Price").

Each of the investors in the Winter 2011 Offering received, for no additional consideration, a warrant (the "Winter 2011 Warrants"), entitling the holder to purchase a number of shares of the Company's common stock equal to 100% of the number of shares of common stock into which the Winter 2011 Notes are convertible (the "Warrant Shares"). Each Winter 2011 Warrant is exercisable on a cash basis only at an initial price of $0.30 per share, and is exercisable immediately upon issuance and for a period of two (2) years from the date of issuance. Up to 10,353,688 Warrant Shares are initially issuable to date on exercise of the Winter 2011 Warrants.

The Company received $2,353,111 in net proceeds in the 2011 Winter Offering which was used for general corporate purposes and working capital. The aggregate value of the 2011 Offering Warrants issued were valued at $1,368,888 using the Black-Scholes-Merton option valuation model with the following assumptions; risk-free interest rate of .25; dividend yield of 0%; volatility factors of the expected market price of common stock of 130%; and an expected life of two years (statutory term) and vest immediately upon issuance. The Company also determined that the notes contained a beneficial conversion feature valued at $984,223. As of June 30, 2011, the aggregate value of the 2011 Winter Offering Warrants, the beneficial conversion feature and the implied discount and transaction fees of $235,311 are considered as debt discount and will be amortized over the life of the notes.

As of June 30, 2011, investors have converted $2,296,372 of the Convertible Notes into 9,185,486 shares of the Company's common stock. The outstanding balance at June 30, 2011 was $292,050.

2011 Spring Offering

From March 14, 2010 through May 31, 2011, the Company conducted a private offering (the "Spring 2011 Offering") of up to $1,000,000 aggregate face amount of its convertible notes (the "Spring 2011 Notes"). A total of $1,469,550 aggregate face amount of the Spring 2011 Notes were sold for an aggregate purchase price of $1,335,955. While there was no stated interest rate on the Spring 2011 Notes, the implied effective interest rate on the Spring 2011 Notes is 10% per annum. The Spring 2011 Notes mature on the first anniversary of their date of issuance. The Spring 2011 Notes are convertible, at the option of the note holder, into 5,878,200 shares of common stock of the Company (the "Conversion Shares") at an initial conversion price of $0.25 per share (the "Conversion Price").

Each of the investors in the Spring 2011 Offering received, for no additional consideration, a warrant (the "Spring 2011 Warrants"), entitling the holder to purchase a number of shares of the Company's common stock equal to 100% of the number of shares of common stock into which the Spring 2011 Notes are convertible (the "Warrant Shares"). Each Spring 2011 Warrant is exercisable on a cash basis only at an initial price of $0.30 per share, and is exercisable immediately upon issuance and for a period of two (2) years from the date of issuance. Up to 5,878,200 Warrant Shares are initially issuable to date on exercise of the Spring 2011 Warrants.

The Company received $1,335,955 in net proceeds in the 2011 Spring Offering which was used for general corporate purposes and working capital. The aggregate value of the 2011 Spring Offering Warrants issued were valued at $726,787 using the Black-Scholes-Merton option valuation model with the following assumptions; risk-free interest rate of .45; dividend yield of 0%; volatility factors of the expected market price of common stock of 119%; and an expected life of two years (statutory term) and vest immediately upon issuance. The Company also determined that the notes contained a beneficial conversion feature valued at $609,168. As of June 30, 2011, the aggregate value of the 2011 Spring Offering Warrants, the beneficial conversion feature and the implied discount and transaction fees of $133,595 are considered as debt discount and will be amortized over the life of the notes.

As of June 30, 2011, investors have converted $969,650 of the Convertible Notes into 3,878,600 shares of the Company's common stock. The outstanding balance at June 30, 2011 was $499,900.

5. Capital stock

During the six months ended June 30, 2011, the Company issued 14,785,666 shares of common stock in exchange for conversion of $3,696,417 of Convertible Notes.

During the six months ended June 30, 2011, the Company issued 81,020 shares of common stock upon cashless exercise of 224,000 warrants.

During the six months ended June 30, 2011, the Company issued 77,778 shares of common stock upon exercise of options at $0.27 per share and valued at $21,000.

During the six months ended June 30, 2011, the Company granted, but did not issue 200,000 shares of common stock for consulting services. These shares were valued at $120,000 based on the trading price at the date of the agreement and were subsequently issued on July 25, 2011.

6. Stock options and warrants

The Company periodically issues stock options and warrants to employees and non-employees in capital raising transactions, for services and for financing costs. Stock-based compensation is measured at the grant date, based on the fair value of the award, and is recognized as expense over the requisite service period. Options vest and expire according to terms established at the grant date.

Options

The Company currently issues stock options to employees, directors and consultants under the 2004 Stock Option Plan (the Plan). The Company could issue options under the Plan to acquire up to 5,000,000 shares of common stock. In February 2006, the board approved an amendment to the Plan (approved by the Shareholders in May 2006), increasing the authorized shares by 2,000,000 shares to 7,000,000 shares. At June 30, 2011, 2,672,108 were available to be granted under the Plan. Prior to 2004, the Company granted 3,250,000 options outside the Plan to officers of the Company of which 250,000 are still outstanding.

Employee options vest according to the terms of the specific grant and expire from 5 to 10 years from date of grant. Non-employee option grants to date are vested upon issuance. The weighted-average, remaining contractual life of employee options outstanding at June 30, 2011 was 8.8 years. Stock option activity for the period January 1, 2011 to June 30, 2011, was as follows:

Options	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at January 1, 2011	4,837,488	$ 0.53		
Granted	17,600,000	0.25		
Exercised	(77,778)	0.27		
Forfeited or expired	(181,818)	0.55		
Outstanding at June 30, 2011	22,177,892	$ 0.31	8.8	$ 2,948,467
Vested and exercisable at June 30, 2011	4,577,892	$ 0.54	5.7	$ 308,467

The weighted average exercise prices, remaining contractual lives for options granted, exercisable, and expected to vest under the Plan as of June 30, 2011 were as follows:

	Outstanding Options			Exercisable Options	
Option Exercise Price Per Share	Shares	Life (Years)	Weighted Average Exercise Exercise Price	Shares	Weighted Average Exercise Price
$0.21 - $ 0.99	21,790,346	8.9	$ .29	4,190,346	$ 0.46
$1.00 - $ 1.99	327,546	3.9	1.25	327,546	1.25
$2.00 - $ 2.26	60,000	0.1	2.26	60,000	2.26
	22,177,892	8.8	$ 0.31	4,577,892	$ 0.54

On January 29, 2011, the Company issued 17,600,000 options to Cecil Bond Kyte, its chairman and chief executive officer. The options have an exercise price of $.25 per share, vest over a five year period, and expire ten years from date of grant. Twenty percent of the options shall vest on each of the first five anniversary dates. In the event of a change of control of the Company, all unvested options shall vest on the date of the change of control. During the six months ended June 30, 2011, the Company amortized $565,248 of compensation cost based on the vesting of the options. Future unamortized compensation expense on the outstanding options at June 30, 2011 is $6,277,041.

Black-Scholes-Merton value of options

During the six months ended June 30, 2011 and 2010, the Company valued options at the grant date using the Black-Scholes-Merton pricing model with the following average assumptions:

	June 30, 2011	**2010**
Expected life (years)	6.0	5.5
Risk free interest rate	1.95%	3.63%
Volatility	135.00%	129.95%
Expected dividend yield	0.00%	0.00%

The weighted average fair value for options granted in 2010 was $0.53. The weighted average fair value for options granted during the six months ended June 30, 2011 was $0.38.

Warrants

The following table summarizes certain information about the Company's stock purchase warrants from January 1, 2011 to June 30, 2011:

Warrants	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at January 1, 2011	22,979,068	$ 0.40		
Granted	16,681,888	0.30		
Exercised	(224,000)	0.47		
Forfeited or expired	(1,735,877)	0.61		
Outstanding at June 30, 2011	37,701,079	$ 0.34	1.5	$ 3,078,230
Vested and exercisable at June 30, 2011	37,701,079	$ 0.34	1.5	$ 3,078,230

	Outstanding Warrants			Exercisable Warrants	
Warrant Exercise Price Per Share	Shares	Life (Years)	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
$0.30 - $ 0.99	36,701,079	1.5	$ 0.33	36,701,079	$ 0.33
$1.00 - $ 1.99	1,000,000	2.0	$ 1.00	1,000,000	$ 1.00
$2.00 - $ 2.70	—	—	$ —	—	$ —
	37,701,079	1.5	$ 0.34	37,701,079	$ 0.34

7. Research and development

The Company has research and development facilities in Morgan Hill, California. The Company has tested products incorporating our ZEFS, MK IV, ELEKTRA and AOT technologies for multiple makes and models diesel engines, motorbikes, boats, generators, lawnmowers, other small engines and pipelines. The Company has purchased test vehicles, test engines and testing equipment. The Company incurred $81,213 and $29,802 and $552,568 and $204,095 for the three and six months ended June 30, 2011 and 2010, respectively, on its research and development activities.

AOT TESTING

In mid-July, 2010, the Company entered into a Letter of Intent with the U.S. Department of Energy-Naval Petroleum Reserve/Rocky Mountain Oilfield Testing Center (RMOTC) in Wyoming. On December 22, 2010, a formal Agreement was entered into with RMOTC for testing of our Applied Oil Technology (AOT). Third-party vendors and suppliers were used by the Company to provide the facility construction materials and the prototype's design and fabrication. To conduct the testing, the Company was responsible for designing and building the testing facility, located on the Naval Petroleum Reserve #3. Design and engineering began on January 6, 2011 and construction was completed on June 30, 2011. Costs incurred for the testing during the six months ended June 30, 2011 was $542,540.

8. Derivative liability

In June 2008, the FASB issued authoritative guidance on determining whether an instrument (or embedded feature) is indexed to an entity's own stock. Under the authoritative guidance, effective January 1, 2009, instruments which do not have fixed settlement provisions are deemed to be derivative instruments. The strike price of the warrants issued by the Company in connection with certain convertible note offerings made during 2009 and 2010 in the aggregate of 8,522,500 warrants, exercisable at $.30 per share, contain exercise prices that may fluctuate based on the occurrence of future offerings or events. As a result, theses warrants are not considered indexed to the Company's own stock. The Company characterized the fair value of these warrants as derivative liabilities upon issuance. The FASB's guidance requires the fair value of these liabilities be re-measured at the end of every reporting period with the change in value reported in the statement of operations.

The derivative liabilities were valued using a probability weighted average series of Black-Scholes-Merton models as a valuation technique with the following assumptions:

	Fair Value of Warrants	
	June 30, 2011	December 31, 2010
Risk-free interest rate	0.45%	0.61%
Expected volatility	115%-120%	120%
Expected life (in years)	1.25 – 1.50	1.75 – 2.00
Expected dividend yield	0%	0%
Fair Value:		
2009 Summer Warrants	$ 462,537	$ 804,100
2009 Wellfleet Warrants	24,735	129,000
2009 Fall Warrants	1,613,819	2,731,575
Total Fair Value	$ 2,101,091	$ 3,664,675

The risk-free interest rate is based on the yield available on U.S. Treasury securities. The Company estimates volatility based on the historical volatility of its common stock. The expected life warrants are based on the expiration date of the related warrants. The expected dividend yield was based on the fact that the Company has not paid dividends to common shareholders in the past and does not expect to pay dividends to common shareholders in the future.

As of June 30, 2011, the Company re-measured the derivative liabilities and determined the fair value to be $2,101,091. For the six months ended June 30, 2011, the Company recorded a gain on the change in fair value of derivatives of $1,563,584.

9. Commitments and contingencies

Legal matters

The Company concluded its litigation in previous matters involving the Company's prior Chairman and Chief Executive, Jeffrey Muller and all related matters and are of the current opinion that the Company no longer faces litigation liability in connection with those cases. The Company is continuing to ensure it's obligations are fully in compliance with a previous injunction order entered by a Federal District Court over six years ago to timely file all of the Company's financial and related reports. The Company will shortly be petitioning the Federal District Court to dissolve the compliance injunction on the basis that for more than a six-year period, under the Company's new administrative and executive leadership, it has been in full compliance with the Company's SEC financial and reporting obligations. The Company can provide no assurance that such action to dissolve the injunction would be successful.

There is no other litigation of any significance with the exception of the matters that have arisen under, and are being handled in, the normal course of business.

Litigation Involving Former Executive Officer

As previously reported, on April 7, 2010, Bruce McKinnon, the former CEO of the Company, and the Company entered into an Agreement Re: Collection on Judgment ("Judgment") (the "Settlement Agreement"), wherein McKinnon, among other things, agreed to cease further collection efforts on the Judgment, and the Company, among other things, agreed to satisfy the Judgment for, and McKinnon agreed to accept as full and final satisfaction of the Judgment, subject to certain payment waivers described below, a total amount of $360,000, plus interest of ten percent (10%) per annum from March 15, 2010, on the unpaid balance until paid, payable as follows: $30,000 on April 7, 2010; $85,000 on or before April 15, 2010; and, $15,000 per month commencing on June 1, 2010, until paid. As of June 30, 2011, all payments have been made on time and the balance due is $74,541. The Settlement Agreement also provides that if the Company makes all payments thereunder on a timely basis, McKinnon will waive final payments due him in the amount of $35,000. On July 15, 2011, the Company made the full and final payment to Bruce McKinnon.

There is no other litigation of any significance with the exception of the matters that have arisen under, and are being handled in, the normal course of business.

10. Subsequent events

Stock Issuance

From July 1, 2011 through July 29, 2011, the Company issued 1,186,384 additional shares of common stock in exchange for the conversion of $296,596 Convertible Notes. The outstanding balance of Convertible Notes at July 29, 2011 is $531,168.

2011 Summer Offering

Since June 24, 2011, the Company has been conducting a private offering (the "Summer 2011 Offering") of up to $500,000 aggregate face amount of its convertible notes (the "Summer 2011 Notes"). The Summer 2011 Offering closed on July 31, 2011. As of July 31, 2011, a total of $487,783 aggregate face amount of the Summer 2011 Notes have been sold for an aggregate purchase price of $443,438. While there is no stated interest rate on the Summer 2011 Notes, the implied effective interest rate on the Summer 2011 Notes is 10% per annum. The Summer 2011 Notes mature on the first anniversary of their date of issuance. The Summer 2011 Notes are convertible, at the option of the note holder, into 1,951,132 shares of common stock of the Company (the "Conversion Shares") at an initial conversion price of $0.25 per share (the "Conversion Price").

Each of the investors in the Summer 2011 Offering will receive, for no additional consideration, a warrant (the "Summer 2011 Warrants"), entitling the holder to purchase a number of shares of the Company's common stock equal to 100% of the number of shares of common stock into which the Summer 2011 Notes are convertible (the "Warrant Shares"). Each Summer 2011 Warrant is exercisable on a cash basis only at an initial price of $0.30 per share, and is exercisable immediately upon issuance and for a period of two (2) years from the date of issuance. Up to 1,951,132 Warrant Shares are initially issuable to date on exercise of the Summer 2011 Warrants.

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

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

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

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

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

Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including those set forth under the heading "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2010. 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

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

We have two product lines; Applied Oil Technology ("AOT") and ELEKTRA™.

Applied Oil Technology is transitioning from the research and development stage to full-scale commercial prototypes, and is in testing with the U.S. Department of Energy. ELEKTRA is in the research and development stage.

We obtained three licenses (the "Licenses") from Temple University for their patent-pending uniform electric field technology, which provide the intellectual property foundations upon which the AOT and ELEKTRA products are based. The AOT technology consists of passing crude oil through an array of dynamically-controlled electrical fields to reduce the viscosity of the oil, making it easier to pump through oil pipelines. The ELEKTRA technology consists of passing fuel through a dynamically-controlled electrical field to assist in the atomization of fuel via fuel injectors. ELEKTRA introduces a uniform electrical field into the fuel flow to reduce the viscosity of diesel fuel, enabling smaller droplets to be released into the combustion chamber of a diesel engine. At December 31, 2010, the Company owed to Temple University a total of $721,785 for the License Agreement, Maintenance Fees, R&D Agreement and penalties and we were in default in those payments. On March 28, 2011, we completed our final adjusted payment to Temple University for all outstanding obligations on the License Agreements and the R&D Agreement.

The Company holds US Patent # 6901917, effective May 21, 2001 for "DEVICE FOR SAVING FUEL AND REDUCING EMISSIONS" covered in the United States, Australia, Canada, China, Russia, India, Indonesia and Mexico for the legacy technology.

We are also working with Temple University and Colfax Corporation (NYSE: CFX) to assist in the development of the commercial version of the AOT technology product line for oil refineries and pipelines. The AOT product line uses the same dynamically-controlled strong electrical field concepts to reduce viscosity as ELEKTRA but is designed for pipeline applications that use thicker, more viscous fuels than the ELEKTRA market. The AOT product is intended to improve the speed of highly viscous fluids such as crude oil traveling through pipelines.

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

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

We are a development stage Company that generated minimal revenues in 2006 and 2007. We did not generate any sales or revenues in 2008, 2009 or 2010. 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 2010 and will need to raise substantial additional capital in 2011, and beyond, to fund our sales and marketing efforts, continuing research and development, and certain other expenses, until our revenue base grows sufficiently to cover such expenditures. See "Management's Discussion and Analysis" below.

Our company was incorporated on February 18, 1998, as a Nevada corporation, under the name Mandalay Capital Corporation. We changed our name to Save the World Air, Inc. on February 11, 1999, following the acquisition of marketing and manufacturing rights of the ZEFS (legacy) technologies. Our mailing address is 735 State Street, Suite 500, Santa Barbara, California 93101. Our telephone number is (805) 845-3581. Our corporate website is www.stwa.com.

Our common stock is quoted under the symbol "ZERO" on the Over-the-Counter Bulletin Board

Results of Operations

We did not generate any revenue for the three-month and six-month periods ended June 30, 2011 and 2010.

Operating expenses were $1,428,251 for the three-month period ended June 30, 2011, compared to $1,058,433 for the three-month period ended June 30, 2010, an increase of $369,818. This increase is attributable to increases in non-cash expenses of $49,141 and cash expenses of $320,677. Specifically, the increase in non-cash expense is attributable to an increase in valuation of options given to employees as compensation of $264,752, offset by decreases in stocks and warrants given to consultants of $215,527 and depreciation of $84. Specifically, the increase in cash expense is attributable to increases in consulting and professional fees of $188,777, office and other expenses of $75,009, corporate expenses of $53,288, salaries and benefits of $6,361, offset by a decrease in travel and related expenses of $2,758.

Operating expenses were $2,511,235 for the six-month period ended June 30, 2011, compared to $2,621,969 for the six-month period ended June 30, 2010, a decrease of $110,734. This decrease is attributable to a decrease in non-cash expenses of $296,897 offset by an increase in cash expenses of $186,163. Specifically, the decrease in non-cash expense is attributable to decreases in stocks and warrants given to consultants of $685,527, stocks given to employees of $91,700 and depreciation of $635, offset by an increase in valuation of options given to employees as compensation of $480,965. Specifically, the increase in cash expense is attributable to increases in consulting and professional fees of $93,540, corporate expenses of $53,935, office and other expenses of $32,938 and salaries and benefits of $11,271, offset by a decrease in travel and related expenses of $5,521.

Research and development expenses were $81,213 for the three-month period ended June 30, 2011, compared to $29,802 for the three-month period ended June 30, 2010, an increase of $51,411. This increase is attributable to an increase in product testing, research and supplies of $77,671, offset by a decrease in contract fees of $26,260.

Research and development expenses were $552,568 for the six-month period ended June 30, 2011, compared to $204,095 for the six-month period ended June 30, 2010, an increase of $348,473. This increase is attributable to an increase in product testing, research and supplies of $548,736, offset by a decrease in contract fees of $200,263.

Other income and expense were $2,886,206 expense for the three-month period ended June 30, 2011, compared to $975,410 income for the three-month period ended June 30, 2010, an increase in expense of $3,861,616. This increase is attributable to increases in interest and financing expense of $1,839,138, change in fair value of derivative liabilities of $2,163,905 and other non-operating expense of $26,913, offset by a decrease in costs to induce conversion of notes of $168,340.

Other income and expense were $2,194,658 expense for the six-month period ended June 30, 2011, compared to $2,795,248 expense for the six-month period ended June 30, 2010, a decrease in expense of $600,590. This decrease is attributable to decreases in cost of private placement of $1,129,212, change in fair value of derivative liabilities of $292,455, costs to induce conversion of notes of $168,340, offset by increases in interest and financing expense of $1,022,671 and an increase in other income of $33,254.

We had a net loss of $4,396,470, or $0.04 per share, for the three-month period ended June 30, 2011, compared to a net loss of $112,825, or $0.00 per share, for the three-month period ended June 30, 2010. We had a net loss of $5,259,261, or $0.06 per share, for the six-month period ended June 30, 2011, compared to a net loss of $5,622,112, or $0.07 per share, for the six-month period ended June 30, 2010. We expect to incur additional net loss in the fiscal year ending December 31, 2011 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

Since its inception, we have been primarily engaged in organizational and pre-operating activities. We have generated insignificant revenues and have incurred accumulated losses of $63,692,181 from February 18, 1998 (Inception) through June 30, 2011. As reflected in the accompanying condensed consolidated financial statements, we had a net loss of $5,259,261 and a negative cash flow from operations of $3,005,779 for the six months ended June 30, 2011, and had a working capital deficiency (excluding derivative liabilities) of $1,458,387 and a stockholders' deficiency of $3,456,765 at June 30, 2011. As a result, our independent registered public accounting firm, in their report on our 2010 consolidated financial statements, raised substantial doubt about our ability to continue as a going concern. The financial statements do not include any adjustments that might be necessary if we are unable to continue as a going concern.

On March 28, 2011, we completed our final adjusted payment to Temple University for all outstanding obligations on the License Agreements and the R&D Agreement.

Our ability to continue as a going concern is dependent upon our ability to raise additional funds and implement our business plan. Our operations from inception, February 18, 1998 to June 30, 2011 have been funded through issuances of our common stock and convertible notes. During this period, we raised an aggregate of $25,414,482 of which $14,598,408 was from the sale of convertible notes. As of June 30, 2011, the outstanding balance of convertible notes was $827,764, of which $499,900 represented the 2011 Spring Offering which closed May 31, 2011. (see “Note 4. Convertible debentures”). We expect substantially all of the outstanding notes will be converted into shares of common stock of the Company (see “Item 5 Other Information”).

On June 30, 2011, we had cash on hand in the amount of $448,362. In addition to the funds on hand, we will require additional funds to continue to operate our business. This includes expenses we will incur in connection with license agreements; product development and commercialization of the AOT and ELEKTRA technologies; 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 ,we have contractual commitments for salaries to one of our executive officers pursuant to an employment agreement, severance payments to a former officer and consulting fees, during 2011 and beyond. In light of our financial commitments over the next several months and its liquidity constraints, we have implemented cost reduction measures in all areas of operations. We intend to review these measures on an ongoing basis and make additional decisions as may be required.

Since June 24, 2011, we have been conducting a private offering (the “Summer 2011 Offering”) of up to $500,000 aggregate face amount of its convertible notes (the “Summer 2011 Notes”). The Summer 2011 Offering closed on July 31, 2011. As of July 31, 2011, a total of $487,783 aggregate face amount of the Summer 2011 Notes have been sold for an aggregate purchase price of $443,438. While there is no stated interest rate on the Summer 2011 Notes, the implied effective interest rate on the Summer 2011 Notes is 10% per annum. The Summer 2011 Notes mature on the first anniversary of their date of issuance. The Summer 2011 Notes are convertible, at the option of the note holder, into 1,951,132 shares of our common stock (the “Conversion Shares”) at an initial conversion price of $0.25 per share (the “Conversion Price”).

Details of Recent Financing Transactions

2009 Fall Offering. From October 2, 2009 to January 15, 2010, we conducted and completed a private offering (the “Fall 2009 Offering”) consisting of an aggregate of $1,588,125 of 7% Convertible Promissory Notes (the “Notes”) with interest compounded quarterly at the annual rate of 7% payable at maturity, and warrants to purchase an aggregate of 6,352,500 shares of our common stock (the “Fall 2009 Warrants”). We received $1,186,875 net proceeds, of which $344,500 was received as of December 31, 2009. The Fall 2009 Notes mature on the second anniversary of the closing of this offering and will be convertible, at the option of the note holder, into up to 6,352,500 shares of our common stock at a conversion price of $0.25 per share. The Fall 2009 Warrants are for a term of three years at an exercise price of $0.30 per share.

Each of the warrant agreements included an anti-dilution provision that allowed for the automatic reset of the exercise price upon any future sale of common stock or warrants at or below the current exercise price. We considered the current Financial Accounting Standards Board guidance of “Determining Whether an Instrument Indexed to an Entity’s Own Stock” which indicates that any adjustment to the fixed amount (either conversion price or number of shares) of the instrument regardless of the probability or whether or not within the issuers’ control, means the instrument is not indexed to the issuers own stock. Accordingly, we determined that as the strike price of these warrants contain exercise prices that may fluctuate based on the occurrence of future offerings or events, and as such is not a fixed amount. As a result, we determined that these warrants are not considered indexed to our own stock and characterized the fair value of these warrants as derivative liabilities upon issuance.

We determined that the fair value of the warrant liability at issuances to be $3,027,815 based upon a probability weighted average Black-Scholes-Merton calculation (See Note 8), of which, $654,978 was recorded on December 31, 2009 and $2,372,837 was recorded on January 15, 2010. We recorded the full value of the derivative of $2,372,837 as a liability at issuance with an offset to valuation discount. As the fair value of the liability of $2,372,837 exceeded the note value of $1,243,625, the excess of the liability over the note amount of $1,129,212 was considered to be cost of the private placement and was recorded upon issuance. The fair value of the warrant liability as of June 30, 2011 was $1,613,819 (see Note 8).

As of June 30, 2011, investors have converted $1,578,125 of the Convertible Notes plus interest of $11,502 into 6,358,507 shares of our common stock. The outstanding balance at June 30, 2011 is $11,062 which includes $1,062 in accrued interest.

2010 Winter Offering. From February 15, 2010 to March 31, 2010, we conducted a private offering (the "Winter 2010 Offering") consisting of an aggregate of $885,863 face amount of its Convertible Promissory Notes (the "Winter 2010 Notes") have been sold for an aggregate purchase price of $805,330. While the stated interest rate on the Winter 2010 Notes is 0%, the implied interest rate on the Winter 2010 Notes is 10% per annum. The Winter 2010 Notes mature on the first anniversary of their date of issuance. The Winter 2010 Notes are convertible, at the option of the note holder, into 2,214,657 shares of our common stock (the "Conversion Shares") at an initial conversion price of $0.40 per share (the "Conversion Price").

Each of the investors in the Winter 2010 Offering received, for no additional consideration, a warrant (the "Winter 2010 Warrants"), entitling the holder to purchase a number of shares of our common stock equal to 100% of the number of shares of common stock into which the Winter 2010 Notes are convertible (the "Warrant Shares"). Each Winter 2010 Warrant is exercisable on a cash basis only at an initial price of $0.40 per share, and is exercisable immediately upon issuance and for a period of two (2) years from the date of issuance. Up to 2,214,657 Warrant Shares are initially issuable to date on exercise of the Winter 2010 Warrants.

We received $805,330 in net proceeds in the Winter 2010 Offering which was used for general corporate purposes and working capital. The aggregate value of the Winter 2010 Offering Warrants issued were valued at $476,268 using the Black-Scholes-Merton option valuation model with the following assumptions; risk-free interest rate of 1.02; dividend yield of 0%; volatility factors of the expected market price of common stock of 135%; and an expected life of two years (statutory term) and vest immediately upon issuance. We also determined that the notes contained a beneficial conversion feature of $329,062. As of June 30, 2011, the aggregate value of the Winter 2010 Offering Warrants, the beneficial conversion feature and the implied discount and transaction fees of $80,533 are considered as debt discount and were fully amortized in conjunction with the conversion of the notes.

As of June 30, 2011, investors have converted $885,863 of the Convertible Notes into 2,214,657 shares of our common stock. There was no outstanding balance at June 30, 2011.

2010 Spring Offering. From April 15, 2010 to April 30, 2010, we conducted a private offering (the "Spring 2010 Offering") consisting of an aggregate of $143,000 face amount of its Convertible Promissory Notes (the "Spring 2010 Notes") have been sold for an aggregate purchase price of $130,000. While the stated interest rate on the Spring 2010 Notes is 0%, the actual interest rate on the Spring 2010 Notes is 10% per annum. The Spring 2010 Notes mature on the first anniversary of their date of issuance. The Spring 2010 Notes are convertible, at the option of the note holder, into 357,500 shares of our common stock (the "Conversion Shares") at an initial conversion price of $0.40 per share (the "Conversion Price").

Each of the investors in the Spring 2010 Offering received, for no additional consideration, a warrant (the "Spring 2010 Warrants"), entitling the holder to purchase a number of shares of our common stock equal to 100% of the number of shares of common stock into which the Spring 2010 Notes are convertible (the "Warrant Shares"). Each Spring 2010 Warrant is exercisable on a cash basis only at an initial price of $0.40 per share, and is exercisable immediately upon issuance and for a period of two (2) years from the date of issuance. Up to 357,500 Warrant Shares are initially issuable to date on exercise of the Spring 2010 Warrants.

We received $130,000 in net proceeds in the Spring 2010 Offering which was used for general corporate purposes and working capital. The aggregate value of the Spring 2010 Offering Warrants issued were valued at $62,730 using the Black-Scholes-Merton option valuation model with the following assumptions; risk-free interest rate of .41; dividend yield of 0%; volatility factors of the expected market price of common stock of 110%; and an expected life of two years (statutory term) and vest immediately upon issuance. We also determined that the notes contained a beneficial conversion feature of $67,270. As of June 30, 2011, the aggregate value of the Spring 2010 Offering Warrants, the beneficial conversion feature and the implied discount and transaction fees of $13,000 are considered as debt discount and were fully amortized in conjunction with the conversion of the notes.

As of June 30, 2011, investors have converted $143,000 of the Convertible Notes into 357,500 shares of our common stock. There was no outstanding balance at June 30, 2011.

2010 Summer Offering. From June 14, 2010 to July 31, 2010, we conducted and concluded a private offering (the "Summer 2010 Offering") consisting of up to $500,000 aggregate face amount of out convertible notes (the " Summer 1010 Notes). A total of $392,150 Summer 2010 Notes were sold to twenty six accredited investors for an aggregate purchase price of $356,500. While the stated interest rate on the Summer 2010 Notes is 0%, the actual interest rate on the Summer 2010 Notes is 10% per annum. The Summer 2010 Notes mature on the first anniversary of of the closing of this offering and will be convertible, at the option of the note holder, into up to 1,568,600 shares of our common stock at a conversion price of $0.25 per share (the "Conversion Price").

Each of the investors in the Summer 2010 Offering will receive, for no additional consideration, a warrant (the "Summer 2010 Warrants"), entitling the holder to purchase a number of shares of our common stock equal to 100% of the number of shares of common stock into which the Summer 2010 Notes are convertible (the "Warrant Shares"). Each Summer 2010 Warrant is exercisable on a cash basis only at an initial price of $0.30 per share, and is exercisable for a period of twenty four months. Up to 1,568,600 Warrant Shares are initially issuable on exercise of the Summer 2010 Warrants.

We received $356,500 in net proceeds in the Summer 2010 Offering which was used for general corporate purposes and working capital. The aggregate value of the Summer 2010 Offering Warrants issued were valued at $209,512 using the Black-Scholes-Merton option valuation model with the following assumptions; risk-free interest rate of .55; dividend yield of 0%; volatility factors of the expected market price of common stock of 132%; and an expected life of two years (statutory term) and vest immediately upon issuance. We also determined that the notes contained a beneficial conversion feature of $146,988. As of June 30, 2011, the aggregate value of the Summer 2010 Offering Warrants, the beneficial conversion feature and the implied discount and transaction fees of $35,650 are considered as debt discount and were fully amortized in conjunction with the conversion of the notes.

As of June 30, 2011, investors have converted $392,150 of the Convertible Notes into 1,568,600 shares of our common stock. There was no outstanding balance at June 30, 2011.

2010 Fall Offering. From August 10, 2010 to September 30, 2010, we conducted and concluded a private offering (the "Fall 2010 Offering") consisting of up to $600,000 aggregate face amount of out convertible notes (the "Fall 1010 Notes). A total of $174,482 Fall 2010 Notes were sold to ten accredited investors for an aggregate purchase price of $158,620. While the stated interest rate on the Fall 2010 Notes is 0%, the actual interest rate on the Fall 2010 Notes is 10% per annum. The Fall 2010 Notes mature on the first anniversary of of the closing of this offering and will be convertible, at the option of the note holder, into up to 697,928 shares of our common stock at a conversion price of $0.25 per share (the "Conversion Price").

Each of the investors in the Fall 2010 Offering will receive, for no additional consideration, a warrant (the "Fall 2010 Warrants"), entitling the holder to purchase a number of shares of our common stock equal to 100% of the number of shares of common stock into which the Fall 2010 Notes are convertible (the "Warrant Shares"). Each Fall 2010 Warrant is exercisable on a cash basis only at an initial price of $0.30 per share, and is exercisable for a period of twenty four months. Up to 697,928 Warrant Shares are initially issuable on exercise of the Fall 2010 Warrants.

We received $158,620 in net proceeds in the Fall 2010 Offering which was used for general corporate purposes and working capital. The aggregate value of the Fall 2010 Offering Warrants issued were valued at $88,113 using the Black-Scholes-Merton option valuation model with the following assumptions; risk-free interest rate of .42; dividend yield of 0%; volatility factors of the expected market price of common stock of 135%; and an expected life of two years (statutory term) and vest immediately upon issuance. We also determined that the notes contained a beneficial conversion feature of $70,507. As of June 30, 2011, the aggregate value of the Summer 2010 Offering Warrants, the beneficial conversion feature and the implied discount and transaction fees of $15,862 are considered as debt discount and were fully amortized in conjunction with the conversion of the notes.

As of June 30, 2011, investors have converted $174,482 of the Convertible Notes into 697,928 shares of ou common stock. There was no outstanding balance at June 30, 2011.

2010 Fall Offering #2

From October 4, 2010 to November 30, 2010, we conducted and concluded a private offering (the "Fall 2010 Offering #2") consisting of up to $3,000,000 aggregate face amount of its convertible notes (the " Fall 2010 Notes). A total of $940,347 Fall 2010 #2 Notes were sold to ten accredited investors for an aggregate purchase price of $849,861. While the stated interest rate on the Fall 2010 #2 Notes is 0%, the actual interest rate on the Fall 2010 #2 Notes is 10% per annum. The Fall 2010 #2 Notes mature on the first anniversary of the closing of this offering and will be convertible, at the option of the noteholder into 3,761,386 shares of our common stock at a conversion price of $0.25 per share (the "Conversion Price").

Each of the investors in the Fall 2010 #2 Offering will receive, for no additional consideration, a warrant (the "Fall 2010 #2 Warrants"), entitling the holder to purchase a number of shares of our common stock equal to 100% of the number of shares of common stock into which the Fall 2010 #2 Notes are convertible (the "Warrant Shares"). Each Fall 2010 Warrant is exercisable on a cash basis only at an initial price of $0.30 per share, and is exercisable for a period of twenty four months. Up to 3,761,386 Warrant Shares are initially issuable on exercise of the Fall 2010 #2 Warrants.

We received $849,861 in net proceeds in the Fall 2010 #2 Offering which was used for general corporate purposes and working capital. The aggregate value of the Fall 2010 #2 Offering Warrants issued were valued at $436,986 using the Black-Scholes-Merton option valuation model with the following assumptions; risk-free interest rate of .27; dividend yield of 0%; volatility factors of the expected market price of common stock of 121%; and an expected life of two years (statutory term) and vest immediately upon issuance. We also determined that the notes contained a beneficial conversion feature of $417,875. As of June 30, 2011, the aggregate value of the Fall 2010 #2 Offering Warrants, the beneficial conversion feature and the implied discount and transaction fees of $85,486 are considered as debt discount and will be amortized over the life of the notes.

As of June 30, 2011, investors have converted $929,347 of the Convertible Notes into 3,717,386 shares of our common stock. The outstanding balance at June 30, 2011 was $11,000.

2011 Winter Offering

From December 13, 2010 through February 28, 2011, we conducted a private offering (the "Winter 2011 Offering") of up to $3,000,000 aggregate face amount of its convertible notes (the "Winter 2011 Notes"). A total of $2,588,422 aggregate face amount of the Winter 2011 Notes were sold for an aggregate purchase price of $2,353,111. While the stated interest rate on the Winter 2011 Notes is 0%, the actual interest rate on the Spring 2011 Notes is 10% per annum. The Winter 2011 Notes mature on the first anniversary of their date of issuance. The Winter 2011 Notes are convertible, at the option of the note holder, into 10,353,688 shares of our common stock (the "Conversion Shares") at an initial conversion price of $0.25 per share (the "Conversion Price").

Each of the investors in the Winter 2011 Offering received, for no additional consideration, a warrant (the "Winter 2011 Warrants"), entitling the holder to purchase a number of shares of our common stock equal to 100% of the number of shares of common stock into which the Spring 2011 Notes are convertible (the "Warrant Shares"). Each Winter 2011 Warrant is exercisable on a cash basis only at an initial price of $0.30 per share, and is exercisable immediately upon issuance and for a period of two (2) years from the date of issuance. Up to 10,353,688 Warrant Shares are initially issuable to date on exercise of the Winter 2011 Warrants.

We received $2,353,111 in net proceeds in the 2011 Winter Offering which was used for general corporate purposes and working capital. The aggregate value of the 2011 Winter Offering Warrants issued were valued at $1,368,888 using the Black-Scholes-Merton option valuation model with the following assumptions; risk-free interest rate of .25; dividend yield of 0%; volatility factors of the expected market price of common stock of 130%; and an expected life of two years (statutory term) and vest immediately upon issuance. We also determined that the notes contained a beneficial conversion feature of $984,223. As of June 30, 2011, the aggregate value of the 2011 Winter Offering Warrants, the beneficial conversion feature and the implied discount and transaction fees of $235,311 are considered as debt discount and will be amortized over the life of the notes.

As of June 30, 2011, investors have converted $2,296,372 of the Convertible Notes into 9,185,486 shares of our common stock. The outstanding balance at June 30, 2011 was $292,050.

2011 Spring Offering

From March 14, 2011 through May 31, 2011, we conducted a private offering (the "Spring 2011 Offering") of up to $1,000,000 aggregate face amount of its convertible notes (the "Spring 2011 Notes"). A total of $1,469,550 aggregate face amount of the Spring 2011 Notes were sold for an aggregate purchase price of $1,335,955. While the stated interest rate on the Spring 2011 Notes is 0%, the actual interest rate on the Spring 2011 Notes is 10% per annum. The Spring 2011 Notes mature on the first anniversary of their date of issuance. The Spring 2011 Notes are convertible, at the option of the note holder, into 5,878,200 shares of our common stock (the "Conversion Shares") at an initial conversion price of $0.25 per share (the "Conversion Price").

Each of the investors in the Spring 2011 Offering received, for no additional consideration, a warrant (the "Spring 2011 Warrants"), entitling the holder to purchase a number of shares of our common stock equal to 100% of the number of shares of common stock into which the Spring 2011 Notes are convertible (the "Warrant Shares"). Each Spring 2011 Warrant is exercisable on a cash basis only at an initial price of $0.30 per share, and is exercisable immediately upon issuance and for a period of two (2) years from the date of issuance. Up to 5,878,200 Warrant Shares are initially issuable to date on exercise of the Spring 2011 Warrants.

We received $1,335,955 in net proceeds in the 2011 Spring Offering which was used for general corporate purposes and working capital. The aggregate value of the 2011 Offering Warrants issued were valued at $726,787 using the Black-Scholes-Merton option valuation model with the following assumptions; risk-free interest rate of .45; dividend yield of 0%; volatility factors of the expected market price of common stock of 119%; and an expected life of two years (statutory term) and vest immediately upon issuance. We also determined that the notes contained a beneficial conversion feature of $609,168. As of June 30, 2011, the aggregate value of the 2011 Spring Offering Warrants, the beneficial conversion feature and the implied discount and transaction fees of $133,595 are considered as debt discount and will be amortized over the life of the notes.

As of June 30, 2011, investors have converted $969,650 of the Convertible Notes into 3,878,600 shares of our common stock. The outstanding balance at June 30, 2011 was $499,900.

Critical Accounting Policies and Estimates

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

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

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

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

Stock-Based Compensation

The Company periodically issues stock options and warrants to employees and non-employees in non-capital raising transactions for services and for financing costs. The Company accounts for stock option and warrant grants issued and vesting to employees based on the authoritative guidance provided by the Financial Accounting Standards Board whereas the value of the award is measured on the date of grant and recognized over the vesting period. The Company accounts for stock option and warrant grants issued and vesting to non-employees in accordance with the authoritative guidance of the Financial Accounting Standards Board whereas the value of the stock compensation is based upon the measurement date as determined at either a) the date at which a performance commitment is reached, or b) at the date at which the necessary performance to earn the equity instruments is complete. Non-employee stock-based compensation charges generally are amortized over the vesting period on a straight-line basis. In certain circumstances where there are no future performance requirements by the non-employee, option grants are immediately vested and the total stock-based compensation charge is recorded in the period of the measurement date.

The fair value of the Company's common stock option grant is estimated using the Black-Scholes option pricing model, which uses certain assumptions related to risk-free interest rates, expected volatility, expected life of the common stock options, and future dividends. Compensation expense is recorded based upon the value derived from the Black-Scholes option pricing model, and based on actual experience. The assumptions used in the Black-Scholes option pricing model could materially affect compensation expense recorded in future periods.

Accounting for Warrants and Derivatives

The Company evaluates all of its financial instruments to determine if such instruments are derivatives or contain features that qualify as embedded derivatives. For derivative financial instruments that are accounted for as liabilities, the derivative instrument is initially recorded at its fair value and is then re-valued at each reporting date, with changes in the fair value reported in the consolidated statements of operations. For stock-based derivative financial instruments, the Company uses a probability weighted average series Black-Scholes-Merton option pricing models to value the derivative instruments at inception and on subsequent valuation dates.

The classification of derivative instruments, including whether such instruments should be recorded as liabilities or as equity, is evaluated at the end of each reporting period. Derivative instrument liabilities are classified in the balance sheet as current or non-current based on whether or not net-cash settlement of the derivative instrument could be required within 12 months of the balance sheet date.

Recent Accounting Pronouncements

In May 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-4, which amends the Fair Value Measurements Topic of the Accounting Standards Codification (ASC) to help achieve common fair value measurement and disclosure requirements in U.S. GAAP and IFRS. ASU No. 2011-4 does not require additional fair value measurements and is not intended to establish valuation standards or affect valuation practices outside of financial reporting. The ASU is effective for interim and annual periods beginning after December 15, 2011. The Company will adopt the ASU as required. The ASU will affect the Company’s fair value disclosures, but will not affect the Company’s results of operations, financial condition or liquidity.

In June 2011, the FASB issued ASU No. 2011-5, which amends the Comprehensive Income Topic of the ASC. The ASU eliminates the option to present the components of other comprehensive income as part of the statement of changes in shareholders’ equity, and instead requires consecutive presentation of the statement of net income and other comprehensive income either in a continuous statement of comprehensive income or in two separate but consecutive statements. ASU No. 2011-5 is effective for interim and annual periods beginning after December 15, 2011. The Company will adopt the ASU as required. It will have no affect on the Company’s results of operations, financial condition or liquidity.

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

Item 3. Quantitative and Qualitative Disclosure about Market Risk

Not applicable.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management evaluated, with the participation of our Chief Executive Officer and Interim 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-Q. Based on this evaluation, our Chief Executive Officer and Interim Chief Financial Officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act") were ineffective as of June 30, 2011 due to the material weaknesses in our internal control over financial reporting described below.

Disclosure controls are procedures that are designed with the objective of ensuring that information required to be disclosed in our reports filed under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls are also designed with the objective of ensuring that such information is accumulated and communicated to our management, including our Chief Executive Officer and Interim Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. Internal control consists of procedures which are designed with the objective of providing reasonable assurance that our transactions are properly authorized, recorded and reported and our assets are safeguarded against unauthorized or improper use, to permit the preparation of our financial statements in conformity with generally accepted accounting principles.

We identified certain matters that constitute material weakness (as defined under the Public Company Accounting Oversight Board Auditing Standard No. 2) in our internal control over financial reporting as discussed on Management's Annual Report on Internal Control Over Financial Reporting below.

In light of the material weaknesses in internal control over financial reporting described below, we performed additional analysis and other post-closing procedures to ensure that our financial statements were prepared in accordance with generally accepted accounting principles. Despite material weaknesses in our internal control over financial reporting, we believe that the financial statements included in our Form 10-Q for the period ended June 30, 2011 fairly present, in all material respects, our financial condition, results of operations, changes in shareholder's equity and cash flows for the periods presented.

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

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

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

Our Chief Executive Officer, Interim Chief Financial Officer and Controller conducted an assessment of the effectiveness of our internal control over financial reporting as of June 30, 2011 based on the framework in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). A material weakness is a deficiency or a combination of deficiencies in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Company's annual or interim financial statements will not be prevented or detected on a timely basis.

Based on that assessment, we have identified the following material weaknesses and have implemented the following remediation of material weaknesses in internal control over financial reporting:

Lack of segregation of duties

We have limited staff in our corporate offices and, as such, there is a lack of segregation of duties. In December 2006 our Controller retired and in January 2007 our Chief Financial Officer retired due to medical problems. We have subsequently hired an Interim Chief Financial Officer and a full-time Controller and our former Controller provides certain financial consulting services.

Lack of documented and reviewed system of internal control

We have an internal control weakness due to the lack of a documented and reviewed system of internal control. We have determined that to perform the processes and remediate this internal control deficiency, we will either need to engage an internal control consultant or reassign existing personnel. We have started to enhance some of our key internal control systems surrounding inventory purchasing and control, and to document those changes; however, this process is on-going and the implementation of policies and procedures may take several quarters.

As a result of the material weaknesses described above, management concluded that, as of June 30, 2011, we did not maintain effective internal control over financial reporting based on the criteria established in *Internal Control – Integrated Framework, issued by COSO*.

We have retained a consulting firm and are conducting an evaluation to design and implement adequate systems of accounting and financial statement disclosure controls. We expect to complete a review during 2011 to comply with the requirements of the SEC, which as required by SEC rules, may include an opinion from our auditors regarding management's report on internal control over financial reporting for our fiscal year ending 2011. We believe that the ultimate success of our plan to improve our internal control over financial reporting will require a combination of additional financial resources, outside consulting services, legal advice, additional personnel, further reallocation of responsibility among various persons, and substantial additional training of those of our officers, personnel and others, including certain of our directors such as our Chairman of the Board and committee chairs, who are charged with implementing and/or carrying out our plan. It should also be noted that the design of any system of controls and procedures is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote.

In addition, our management with the participation of our Chief Executive Officer and Interim Chief Financial Officer have determined that no change in our internal control over financial reporting (as that term is defined in Rules 13(a)-15(f) and 15(d)-15(f) of the Securities Exchange Act of 1934) occurred during or subsequent to the quarter ended September 30, 2010 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II

Item 1. Legal Proceedings

We have concluded our litigation in previous matters involving the Company's prior Chairman and Chief Executive, Jeffrey Muller and all related matters and are of the current opinion that the Company no longer faces litigation liability in connection with those cases. We are continuing to ensure the Company's obligations are fully in compliance with a previous injunction order entered by a Federal District Court over six years ago to timely file all of the Company's financial and related reports. The Company will shortly be petitioning the Federal District Court to dissolve the compliance injunction on the basis that for more than a six-year period, under the Company's new administrative and executive leadership, it has been in full compliance with the Company's SEC financial and reporting obligations. We can provide no assurance that such action to dissolve the injunction would be successful.

There is no other litigation of any significance with the exception of the matters that have arisen under, and are being handled in, the normal course of business.

Litigation Involving Former Executive Officer

As previously reported, on April 7, 2010, Bruce McKinnon, the former CEO of the Company, and the Company entered into an Agreement Re: Collection on Judgment ("Judgment") (the "Settlement Agreement"), wherein McKinnon, among other things, agreed to cease further collection efforts on the Judgment, and the Company, among other things, agreed to satisfy the Judgment for, and McKinnon agreed to accept as full and final satisfaction of the Judgment, subject to certain payment waivers described below, a total amount of $360,000, plus interest of ten percent (10%) per annum from March 15, 2010, on the unpaid balance until paid, payable as follows: $30,000 on April 7, 2010; $85,000 on or before April 15, 2010; and, $15,000 per month commencing on June 1, 2010, until paid. As of June 30, 2011, all payments have been made on time and the balance due is $74,541. The Settlement Agreement also provides that if the Company makes all payments thereunder, on a timely basis, McKinnon will waive final payments due him in the amount of $35,000. On July 15, 2011, the Company made the full and final payment to Bruce McKinnon.

There is no other litigation of any significance with the exception of the matters that have arisen under, and are being handled in, the normal course of business.

Item 1A. Risk Factors

There have been no material changes in the risk factors previously disclosed in Form 10-K for the period ended December 31, 2010, which we filed with the SEC on March 31, 2011.

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

2009 Fall Offering. From October 2, through January 15, 2010, the Company conducted a private offering (the "2009 Fall Offering") consisting of an aggregate of $1,588,125 of Convertible Promissory Notes. The Notes were sold for $1,186,875 net proceeds, and the Company converted existing liabilities of $401,250 to these notes. The Notes are convertible into 6,352,500 shares of our common stock and in addition investors received warrants to purchase up to 6,352,500 shares of our common stock. (See "Details of Recent Financing Transactions").

2010 Spring Offering. From February 15, 2010 through June 30, 2010, we conducted a private offering (the "2010 Spring Offering") and issued Convertible Notes in the aggregate face amount of $885,863. These Notes were sold for an aggregate purchase price of $805,330 net proceeds. The Notes are convertible into 2,214,657 shares of our common stock and in addition, investors received warrants entitling the holders to purchase up to 2,214,657 shares of our common stock. (See "Details of Recent Financing Transactions").

2010 Spring Offering. From April 15, 2010 through April 30, 2010, we conducted a private offering (the "2010 Spring Offering") and issued Convertible Notes in the aggregate face amount of $143,000. These Notes were sold for an aggregate purchase price of $130,000 net proceeds. The Notes are convertible into 357,000 shares of our common stock and in addition, investors received warrants entitling the holders to purchase up to 357,000 shares of our common stock. (See "Details of Recent Financing Transactions").

2010 Summer Offering. From June 14, 2010 through July 31, 2010, we conducted a private offering (the "2010 Summer Offering") and issued Convertible Notes in the aggregate face amount of $392,150. These Notes were sold for an aggregate purchase price of $356,500 net proceeds. The Notes are convertible into 1,568,600 shares of our common stock and in addition, investors received warrants entitling the holders to purchase up to 1,568,600 shares of our common stock. (See "Details of Recent Financing Transactions").

2010 Fall Offering. From August 10, 2010 through September 30, 2010, we conducted a private offering (the "2010 Fall Offering") and issued Convertible Notes in the aggregate face amount of $174,482. These Notes were sold for an aggregate purchase price of $158,620 net proceeds. The Notes are convertible into 697,928 shares of our common stock and in addition, investors received warrants entitling the holders to purchase up to 697,928 shares of our common stock. (See "Details of Recent Financing Transactions").

2010 Fall#2 Offering. From October 4, 2010 through November 30, 2010, we conducted a private offering (the "2010 Fall#2 Offering") and issued Convertible Notes in the aggregate face amount of $940,347. These Notes were sold for an aggregate purchase price of $849,861 net proceeds. The Notes are convertible into 3,761,386 shares of our common stock and in addition, investors received warrants entitling the holders to purchase up to 3,761,386 shares of our common stock. (See "Details of Recent Financing Transactions").

2011 Winter Offering. From December 13, 2010 through February 28, 2011, we conducted a private offering (the "2011 Winter Offering") and issued Convertible Notes in the aggregate face amount of $2,588,422. These Notes were sold for an aggregate purchase price of $2,353,111 net proceeds. The Notes are convertible into 10,353,688 shares of our common stock and in addition, investors received warrants entitling the holders to purchase up to 10,353,699 shares of our common stock. (See "Details of Recent Financing Transactions").

2011 Spring Offering. From March 14, 2011 through May 31, 2011, we conducted a private offering (the "2011 Spring Offering") and issued Convertible Notes in the aggregate face amount of $1,469,550. These Notes were sold for an aggregate purchase price of $1,335,955 net proceeds. The Notes are convertible into 5,878,200 shares of our common stock and in addition, investors received warrants entitling the holders to purchase up to 5,878,200 shares of our common stock. (See "Details of Recent Financing Transactions").

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

Other Issuances.

During the six months ended June 30, 2011, we issued 14,785,666 shares of common stock in exchange for conversion of $3,696,417 of Convertible Notes.

During the six months ended June 30, 2011we issued 81,020 shares of common stock upon cashless exercise of warrants.

During the six months ended June 30, 2011, we issued 77,778 shares of common stock upon exercise of options at $0.27 per share and valued at $21,000.

During the six months ended June 30, 2011, we granted, but did not issue 200,000 shares of common stock for consulting services. These shares were valued at $120,000 based on the trading price at the date of the agreement and were subsequently issued on July 25, 2011.

Item 3. Defaults Upon Senior Securities

None

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

None

Item 5. Other Information

On January 29, 2011, the Company issued 17,600,000 options to Cecil Bond Kyte, its chairman and chief executive officer. The options have an exercise price of $.25 per share, vest over a five year period, and expire ten years from date of grant. Twenty percent of the options shall vest on each of the first five anniversary dates. In the event of a change of control of the Company, all unvested options shall vest on the date of the change of control. During the six months ended June 30, 2011, the Company amortized $557,190 of compensation cost based on the vesting of the options. Future unamortized compensation expense on the outstanding options at June 30, 2011 is $6,129,106. As of June 30, 2011, the market price of the Company's stock was $0.40 per share and the aggregate intrinsic value of the options outstanding and exercisable was $308,467.

Stock Issuance

From July 1, 2011 through July 29, 2011, we issued 1,186,384 additional shares of our common stock in exchange for the conversion of $296,596 Convertible Notes. The outstanding balance of Convertible Notes at July 29, 2011 is $531,168.

2011 Summer Offering

Since June 24, 2011, we have been conducting a private offering (the "Summer 2011 Offering") of up to $500,000 aggregate face amount of its convertible notes (the "Summer 2011 Notes"). The Summer 2011 Offering closed on July 31, 2011. As of July 31, 2011, a total of $487,783 aggregate face amount of the Summer 2011 Notes have been sold for an aggregate purchase price of $443,438. While there is no stated interest rate on the Summer 2011 Notes, the implied effective interest rate on the Summer 2011 Notes is 10% per annum. The Summer 2011 Notes mature on the first anniversary of their date of issuance. The Summer 2011 Notes are convertible, at the option of the note holder, into 1,951,132 shares of our common stock (the "Conversion Shares") at an initial conversion price of $0.25 per share (the "Conversion Price").

Each of the investors in the Summer 2011 Offering will receive, for no additional consideration, a warrant (the "Summer 2011 Warrants"), entitling the holder to purchase a number of shares of our common stock equal to 100% of the number of shares of common stock into which the Summer 2011 Notes are convertible (the "Warrant Shares"). Each Summer 2011 Warrant is exercisable on a cash basis only at an initial price of $0.30 per share, and is exercisable immediately upon issuance and for a period of two (2) years from the date of issuance. Up to 1,951,132 Warrant Shares are initially issuable to date on exercise of the Summer 2011 Warrants.

Item 6. Exhibits

Exhibit No.	Description
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 Interim Chief Financial Officer of Quarterly Report pursuant to Rule 13(a)-15(e) or Rule 15(d)-15(e)
32	Certification of Chief Executive Officer and Interim Chief Financial Officer of Quarterly Report Pursuant to 18 U.S.C. Section 1350
101.INS	XBRL Instance Document
101.SCH	XBRL Schema Document
101.CAL	XBRL Calculation Linkbase Document
101.LAB	XBRL Label Linkbase Document
101.PRE	XBRL Presentation Linkbase Document
101.DEF	XBRL Definition Linkbase Document

SIGNATURES

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

SAVE THE WORLD AIR, INC.

Date: August 10, 2011

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

EXHIBIT INDEX

Exhibit No.	Description
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101.DEF	XBRL Definition Linkbase Document

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, Cecil Bond Kyte, certify that:

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

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

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

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

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

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

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

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

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

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

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

Date: August 10, 2011

/s/ CECIL BOND KYTE
Cecil Bond Kyte
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, Eugene E. Eichler, certify that:

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

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

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

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

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

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

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

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

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

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

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

Date: August 10, 2011

/s/ EUGENE E. EICHLER
Eugene E. Eichler
Interim 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-Q of the Company for the quarter ended March 31, 2011 (the "Report") fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934 and that the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 10, 2011	/s/ CECIL BOND KYTE Cecil Bond Kyte Chief Executive Officer
Date: August 10, 2011	/s/ EUGENE E. EICHLER Eugene E. Eichler Interim Chief Financial Officer